

No. 87 541

Supreme Court, U.S.

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**IN THE
SUPREME COURT
OF THE UNITED STATES**

OCTOBER TERM, 1987

DANBURY, INC.,

Petitioner,

vs.

**ANTHONY P. OLIVE, DIRECTOR
BUREAU OF INTERNAL REVENUE
GOVERNMENT OF THE VIRGIN ISLANDS,**

Respondent.

**PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT**

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QUESTIONS PRESENTED

1. Did Congress specifically create a separate and distinct local income tax law for the territory of the Virgin Islands under Article 4, § 3, cl. 2, of the United States Constitution applicable to Danbury;

OR

Did Congress merely impose the United States income tax law on the Virgin Islands under Article 1 and the Sixteenth Amendment to the Constitution to which Danbury is subject?

2. Do the United States Courts of Appeal have authority to impose United States income tax law on the Virgin Islands if Congress has not specifically acted to do so?

3. Does the "mirror system" of taxation prescribe the Virgin Islands income tax law including Internal Revenue Code ("IRC"), §§ 882(b) and 7701(a), excluding from the mirror system only those sections of the Internal Revenue Code which Congress has specifically applied to the Virgin Islands, e.g. §§ 881, 897, 934, and 936?

4. What is the continuing vitality of the Naval Appropriation Act of 1921 (Title 48 U.S.C. § 1397), which is the genesis of the mirror system, after revocation of the "inhabitant rule" under the Revised Organic Act of 1954, § 28(a) (Title 48 U.S.C. § 1645) by the Tax Reform Act of 1986? Is the United States income tax still "... likewise in force in the Virgin Islands ... paid into the treasuries of said islands: ...," as provided in the Naval Appropriation Act, or

did the Tax Reform Act of 1986 implicitly, but not specifically, also revoke the Naval Appropriation Act?

RULE 28.1 LIST

Danbury has no parent companies, subsidiaries or affiliates. Each of two shareholders, John M. Aschieris and M. Douglas, own 1,250 shares of common stock which is the entire issued and outstanding stock of Danbury.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
RULE 28.1 LIST	ii
TABLE OF AUTHORITIES	vii
OPINIONS BELOW	1
JURISDICTION	2
STATUTORY AUTHORITY INVOLVED	2
STATEMENT UNDER RULE 28.4(b)	3
STATEMENT OF THE CASE	4
REASONS FOR GRANTING THE WRIT	6
INTRODUCTION	6
I. WITHOUT CONGRESSIONAL AUTHORITY, THE THIRD CIRCUIT HAS UNCONSTITUTIONALLY IMPOSED THE UNITED STATES INCOME TAX ON DANBURY, A VIRGIN ISLANDS INHABITANT.	7
II. THE SECOND CIRCUIT AND THE THIRD CIRCUIT ARE IN CONFLICT OVER THEIR JUDICIAL POWER TO ENACT TAX LAWS.	9
III. HAS THE TAX REFORM ACT OF 1986 IMPLICITLY REVOKED THE NAVAL APPROPRIATION ACT OF 1921?	10

IV.	THE DISTRICT COURT OF THE VIRGIN ISLANDS IS WITHOUT AUTHORITY TO DECIDE UNITED STATES INCOME TAX MATTERS.	11
V.	THE “ANY PRE-1986 OPEN YEAR” EFFECTIVE DATE UNDER TRA-86 § 1277(c)(2) IS CONSTITUTIONALLY DEFECTIVE.	12
VI.	THE THIRD CIRCUIT INCORRECTLY DECIDED THAT THE “PRE-1987 OPEN YEAR” EFFECTIVE DATE WAS “ADMINISTRATIVE” AND NOT SUBSTANTIVE.	13
VII.	THE RETROACTIVITY OF § 1277(c)(2) IS ADMINISTRATIVE AND DOES NOT VIOLATE CONSTITUTIONAL PRINCIPLES, OR <i>CONTRA</i> , THE IRS’ UNLIMITED RETROACTIVITY POSITION IS INVALID.	16
VIII.	THE <i>DANBURY</i> DECISION AND PRIOR DECISIONS OF THE THIRD CIRCUIT ARE IN CONFLICT AND DISARRAY CAUSING CHAOS FOR VIRGIN ISLANDS INHABITANTS IN THE DETERMINATION OF THEIR INCOME TAXES.	18

IX. THE VIRGIN ISLANDS BIR IS WITHOUT AUTHORITY TO IMPOSE, ENFORCE AND COLLECT A UNITED STATES INCOME TAX.	23
X. THE <i>DANBURY</i> DECISION RESTORES DISCREDITED LAW.	25
XI. WHY DID CONGRESS CHANGE THE LAW — THE THIRD CIRCUIT'S VIRGIN ISLANDS DUAL TAX THEORY IS WRONG.	26
CONCLUSION	27
APPENDIX A	
Memorandum Opinion of the District Court of the Virgin Islands, Filed January 24, 1986	1a
APPENDIX B	
Opinion of the United States Court of Appeals for the Third Circuit, Filed June 5, 1987	18a
APPENDIX C	
Sur Petition for Rehearing Denied by United States Court of Appeals for the Third Circuit	42a
APPENDIX D	
The Tax Reform Act of 1986, Section 1274, et seq.	44a

APPENDIX E

Brief for the Commissioner of Internal Revenue as Amicus Curiae	59a
--	-----

APPENDIX F

“Tax Structure of the U. S. Virgin Islands,” published by the Virgin Islands Bureau of Internal Revenue	81a
--	-----

TABLE OF AUTHORITIES

Cases	Page
U.S. v. Hudson, 299 U.S. 498 (1937)	13
Chicago Bridge and Iron Co. v. Wheatley, 430 F.2d 973; cert. denied 401 U.S. 910	6, 20
Dudley v. Commissioner of Internal Revenue, 258 F.2d 182 (1958)	8, 11, 19, 22, 23, 24, passim
Fairchild, Estate of, 24 T.C. 408 (1955)	9
HMW Industries, Inc. v. Wheatley, 504 F.2d 146 (1974)	19
Johnson v. Quin, 821 F.2d 212 (1987)	15, 21
Lawrence v. Wardell, 273 F. 405 (9th Cir., 1921)	8
Louise Home, T.C. Memo 1983-589	10
Pan American World Airway, Inc. v. Virgin Islands, 459 F.2d 387 (1972)	20
Rivera's Estate, Commissioner of Internal Revenue v. 214 F.2d 60 (2d Cir., 1954)	8, 9
Smallwood, Estate of, 11 T.C. 740 (1948)	8, 9

Virgin Islands v. Blumenthal, 642 F.2d 641, cert. denied 451 U.S. 983	6
Vitco, Inc. v. Government of the Virgin Islands, et al., 560 F.2d 180; cert. denied 435 U.S. 980	6

United States Constitution

Constitution, Article 1	
§ 2, cl. 3	7
§ 8, cl. 1	7
§ 9, cl. 4	7
Constitution, Article 4	
§ 3, cl. 2	8
Constitution, Sixteenth Amendment	8

Statutes

Tax Reform Act of 1986 ("TRA-86"), §§ 1274, et seq., Public Law 99-514	3, 5
§ 1275(a)	15
§ 1275(b)	10, 11, 15
§ 1277(c)(2)	11, 12, 15, 16, 17
Title 26 U.S.C.	
§ 882(b) ("IRC")	3
§ 6212(a) ("IRC")	3, 25
§ 7651(5)(B) ("IRC")	3
§ 7701(a) ("IRC")	3, 8
Title 28 U.S.C.	
§ 451	4

§ 1254(1)	2
§ 2403(a)	4
Title 48 U.S.C.	
§ 1397, ("Naval Appropriation Act of 1921")	2, passim
§ 1612(a)	2, 4, 11
§ 1642 ("ROA § 28(a)")	3, 5, 6, 12, 13, passim
Title 33 Virgin Islands Code	
§ 944	2, 4

Regulations

Reg. § 1.901-1(g)	14, 15
Revenue Ruling 80-40, 1980-1 CB, 175 ..	5, 22, 26

Miscellaneous

Tax Structure of the Virgin Islands	26
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The petitioner, Danbury, respectfully prays that a writ of certiorari issue to review the judgment and opinions of the United States Court of Appeals for the Third Circuit, entered in the above-entitled proceeding June 5, 1987.

OPINIONS BELOW

The decision of the District Court of the Virgin Islands granting Danbury's motion for summary judgment is reported at 627 F. Supp. 513, and is reprinted in Appendix A, page 1a, *infra*. The opinion of the United States Court of Appeals for the Third Circuit is reported at 820 F.2d 618, and is reprinted in Appendix B, page 18a, *infra*. The order of the United States Court of Appeals for the Third Circuit denying

Danbury's petition for rehearing is reprinted in Appendix C, page 42a, *infra*.

JURISDICTION

The District Court of the Virgin Islands had jurisdiction and authority to hear and decide Danbury's motion for summary judgment pursuant to Title 33 Virgin Islands Code § 944 and Local Rule 14 thereunder, and Title 48 U.S.C. § 1612(a). The date of judgment of the Court of Appeals for the Third Circuit and the time of its entry was June 5, 1987. Appendix B, page 18a, *infra*; and Danbury's timely motion for rehearing was denied by order of the Court of Appeals for the Third Circuit, July 6, 1987. Appendix C, page 42a, *infra*. Danbury seeks review of the Court of Appeals judgment.

The jurisdiction of the Supreme Court is invoked under Title 28 U.S.C. § 1254(1).

STATUTORY AUTHORITY INVOLVED

The statutes involved are as follows:

1. The Naval Appropriation Act of 1921, Title 48 U.S.C. § 1397, parsed to include the relevant portion, provides:

"The income-tax laws in force in the United States of America and those which may hereafter be enacted shall be held to be likewise in force in the Virgin Islands of the United States, except that the proceeds of such taxes shall be paid into the treasuries of said islands: . . . "

2. The Revised Organic Act of 1954, Section 28(a), as amended (herein "ROA § 28(a)"), Title 48 U.S.C. § 1642, parsed to include the relevant portions, provides:

" . . . , [T]he proceeds of the United States income tax, . . . levied by the Congress on the inhabitants of the Virgin Islands, . . . shall be covered into the Treasury of the Virgin Islands, and shall be available for expenditure as the Legislature of the Virgin Islands may provide: *Provided*, That the term 'inhabitants of the Virgin Islands' as used in this Section shall include all persons whose permanent residence is in the Virgin Islands, and such persons shall satisfy their income tax obligations under applicable taxing statutes of the United States by paying their tax on income derived from all sources both within and outside the Virgin Islands into the treasury of the Virgin Islands: . . . "

3. Title 26 U.S.C. (the Internal Revenue Code, herein "IRC"), §§ 882(b), 6212(a), 7651(5)(B) and 7701(a).

4. The Tax Reform Act of 1986 (herein "TRA-86"), §§ 1274, *et seq.*, Public Law 99-514 (Appendix D, page 44a, *infra*).

STATEMENT UNDER RULE 28.4(b)

Since the proceeding draws into question the constitutionality of the Tax Reform Act of 1986, §§ 1274, *et seq.*, Public Law 99-514, an Act of Congress affecting the public interest, and neither the United

States nor any agency, officer, or employee thereof is a party, it is noted that 28 U.S.C. § 2403(a) may be applicable.

No court of the United States as defined by 28 U.S.C. § 451 has, pursuant to 28 U.S.C. § 2403(a), certified to the Attorney General the fact that the constitutionality of such Act of Congress has been drawn in question.

STATEMENT OF THE CASE

The District Court of the Virgin Islands had jurisdiction and authority to hear and decide Danbury's motion for summary judgment pursuant to Title 33 Virgin Islands Code § 944 and Local Rule 14 thereunder, and Title 48 U.S.C. § 1612(a).

Danbury's statement of the case is as follows:

1. *The Material Facts Herein are Few and Clear* — The material facts herein are undisputed by either party (except the ultimate fact of Danbury's income tax deficiency, which Danbury strongly disputes). The material facts are as follows:

(a) Danbury is a corporation duly organized and existing under Nevada law and is a *foreign corporation* with respect to the Virgin Islands.

(b) Danbury is a *V.I. inhabitant* as stated in the statutory notice of deficiency (herein "90 day letter") issued by the Virgin Islands, Bureau of Internal Revenue (herein "BIR"), and as decided by the Court of Appeals for the Third Circuit (herein "Third Circuit").

(c) For calendar years ending December 31, 1981, and December 31, 1982, Danbury did not include in its taxable income "foreign source income" as acknowledged and characterized by the BIR and shown on its Virgin Islands tax returns for those years in the amounts of \$256,118 and \$526,057, respectively (as stated in the BIR 90 day letter).

(d) Danbury is an investment company and has not been engaged in a trade or business.

There are no other material facts relevant to a determination of Danbury's 1981 and 1982 tax liability under Virgin Islands income tax law.

Prior to enactment of TRA-86, October 22, 1986, Virgin Islands inhabitant corporations, e.g. Danbury, were not required to file tax returns or pay income tax to the United States Treasury, Internal Revenue Service (herein "IRS"). ROA § 28(a). Revenue Ruling 80-40, 1980-1 CB, 175.

2. *District Court Decision* — Upon Danbury's motion for summary judgment and the BIR counter motion for summary judgment, the Virgin Islands District Court decided that Danbury had no income tax liability to either the Virgin Islands or the United States on its United States source investment income which was foreign source income with respect to the Virgin Islands. Appendix A, page 1a, *infra*.

3. *Decision of Third Circuit on Appeal* — On appeal by the BIR, the Third Circuit reversed the District Court and decided that Danbury had income tax liability on such foreign source income and remanded the case to the Virgin Islands District Court to decide the impact of TRA-86, i.e., whether such tax was

properly enforceable and collectable by the BIR or IRS. Appendix B, page 18a, *infra*. Danbury's motion for a rehearing was denied July 6, 1987.

REASONS FOR GRANTING THE WRIT

INTRODUCTION

Since enactment of ROA § 28(a), three cases have been referred to the Supreme Court on writ of certiorari involving Virgin Islands tax issues. *Chicago Bridge and Iron Co. v. Wheatley*, 430 F.2d 973, cert. denied, 401 U.S. 910. *Vitco, Inc. v. Government of the Virgin Islands, et al.*, 560 F.2d 180, cert. denied 435 U.S. 980. *Virgin Islands v. Blumenthal*, 642 F.2d 641, cert. denied 451 U.S. 983. None of these writs have been granted. The decision of the Third Circuit in this case involves every Virgin Islands taxpayer and every return filed since 1935. Appendix B, page 39a, *infra*. At least sixty cases are stayed in the Virgin Islands District Court pending a final judgment herein.¹ The Court will not want to overlook this renewed opportunity to remove the uncertainty of every Virgin Islands inhabitant taxpayer concerning his income tax liability over the past forty-two years.

¹ The BIR used this number in its brief before the Third Circuit.

I

**WITHOUT CONGRESSIONAL AUTHORITY,
THE THIRD CIRCUIT HAS UNCONSTITU-
TIONALLY IMPOSED THE UNITED STATES
INCOME TAX ON DANBURY, A VIRGIN
ISLANDS INHABITANT.**

Without any citation of authority, the Third Circuit decided for the first time that Danbury, a Virgin Islands inhabitant, owed a United States income tax, payable nevertheless to the Virgin Islands. Referring to the proviso in ROA § 28(a), the Third Circuit declared “(t)his proviso implements Congress’ stated goal of depositing proceeds from the United States income tax into the treasury of the Virgin Islands. ‘(I)ncome tax obligations under the applicable taxing statutes of the United States’ in Section 28(a) means just that — taxes owed *under applicable provisions of the non-mirrored Internal Revenue Code.*” (Emphasis added) Appendix B, page 28a, *infra*. The “non-mirrored Internal Revenue Code” referred to by the Third Circuit is described in its opinion as the United States Internal Revenue Code — not the mirrored Virgin Islands Revenue Code.

Constitutional authority for Congress to impose income taxes with respect to the States and such taxes with respect to its territories is derived from separate sources.

The constitutional authority of Congress to impose an income tax with respect to the United States and the several States is derived from Article 1, § 2, cl. 3; Article 1, § 8, cl. 1; Article 1, § 9, cl. 4; and the

Sixteenth Amendment. Article 1 and the Sixteenth Amendment refer exclusively to "... the several States ..." and the "... United States. ..." The United States as defined by IRC § 7701(a)(9) "... includes only the States and the District of Columbia" The territories are not included in this definition. This is consistent with prior judicial observations. *Dudley v. Commissioner of Internal Revenue*, 258 F.2d 182, 185, fn. 4.

Congress' constitutional authority to enact income taxes for the territories is derived from Article 4, § 3, cl. 2, which grants Congress the power to "... make all needful Rules and Regulations respecting the Territory ... belonging to the United States; ..."

This distinction was first observed in *Lawrence v. Wardell*, 273 F. 405 (9th Cir., 1921) and cited as authority in the Third Circuit's scholarly opinion in *Dudley v. Commissioner*, *supra*, at page 185, where the Court recognized that "... we are satisfied that the tax here in dispute is actually not a tax of the United States but a territorial income tax ...", *supra*, at page 184. (The Third Circuit not only failed to follow its own *Dudley* opinion in *Danbury* but disdained without overruling *Dudley* to even cite it in *Danbury*.)

The Courts have observed and followed the premise that unless Congress specifically enacts a tax law for the territories under Article 4, § 3, cl. 2, the tax laws which it enacts with respect to the United States and the several States are not in force in the territories. This was the foundation for the Court's refusal to impose an estate tax on United States citizens resident in the Virgin Islands and Puerto Rico in *Commissioner v. Rivera's Estate*, 214 F.2d 60 (2d Cir. 1954); *Estate of*

Smallwood, 11 T.C. 740 (1948); and *Estate of Fairchild*, 24 T.C. 408 (1955).

For the first time in United States judicial history a court has imposed a tax where Congress has elected not to so act. The Third Circuit has imposed the United States income tax on Danbury without any Congressional warrant.

The Supreme Court may wish to act to define the Appeals Court's power to impose new tax laws.

II

THE SECOND CIRCUIT AND THE THIRD CIRCUIT ARE IN CONFLICT OVER THEIR JUDICIAL POWER TO ENACT TAX LAWS.

The Second Circuit has decided that where Congress has not specifically enacted a tax law for a possession or territory, that such a tax is not in force therein. See *Commissioner v. Rivera's Estate*, *supra*.

The Third Circuit in this, the *Danbury* case, has declared that the United States income tax is in force in the Virgin Islands without the benefit of any Congressional action to this effect. Appendix B, page 28a, *infra*.

The Supreme Court may see fit to resolve this conflict between the Second and Third Circuits.

III

HAS THE TAX REFORM ACT OF 1986 IMPLICITLY REVOKED THE NAVAL APPROPRIATION ACT OF 1921?

Section 1275(b) of TRA-86 revokes the "inhabitant rule" of ROA § 28(a) which provided, inter alia, that such inhabitants "... shall satisfy their income tax obligations ... by paying their tax into the treasury of the Virgin Islands: ..."

The Naval Appropriation Act of 1921, which has not been specifically revoked, referring to the income tax provides, inter alia, "... that the proceeds of such taxes shall be paid into the treasuries of said islands: ...", referring to the Virgin Islands.

Congress did not revoke the Naval Appropriation Act of 1921, which is the genesis of the "mirror system" of the Virgin Islands income tax. The Virgin Islands income tax law has been thrown into a chaotic condition. Do hundreds of thousands of Virgin Islands inhabitants, including corporate inhabitants, e.g. Danbury, now pay their income taxes determined under United States income tax law into the United States Treasury or, as provided by the Naval Appropriation Act, do they pay their income taxes under the Virgin Islands mirror system into the Virgin Islands Treasury?

The Courts do not favor revocation of tax laws by implication except when the earlier and later statutes are irreconcilable. See *Louise Home*, T.C. Memo 1983-589 and Supreme Court cases cited therein.

While the Third Circuit remanded the *Danbury* case to the Virgin Islands District Court to determine the payee of Danbury's tax liability — either the United States or the Virgin Islands — it failed to consider or remand for consideration the continuing existence and vitality of the Naval Appropriation Act. Filing tax returns and payment to the Virgin Islands will expose Virgin Islands taxpayers to an IRS deficiency notice. Filing tax returns and payment to the United States will leave such taxpayers exposed to a Virgin Islands notice of deficiency. Every Virgin Islands inhabitant taxpayer is exposed to double taxation.

IV

THE DISTRICT COURT OF THE VIRGIN ISLANDS IS WITHOUT AUTHORITY TO DECIDE UNITED STATES INCOME TAX MATTERS.

The Third Circuit has remanded the *Danbury* case to the Virgin Islands District Court to decide whether Danbury owes income tax to the United States Treasury Department under TRA-86 §§ 1277(c), 1275(b).

The Virgin Islands District Court is empowered under Title 48 U.S.C. § 1612(a) to decide matters arising under the Virgin Islands income tax law, but not the United States income tax law. See *Dudley v. Commissioner*, *supra* at page 188.

The remand of the Third Circuit directs the District Court to take an action that it is not empowered by Congress to undertake.

V

THE “ANY PRE-1987 OPEN YEAR” EFFECTIVE DATE UNDER TRA-86 § 1277(c)(2) IS CONSTITUTIONALLY DEFECTIVE.

The Third Circuit has remanded this case for the District Court to decide whether Danbury’s 1981 and 1982 income tax is to be collected by the Virgin Islands or the United States Treasury. Such tax would be collected by the United States Treasury only if the pre-1987 open year effective date is constitutionally valid. If the retroactive pre-1987 open year effective date is invalid, the inhabitant rule under ROA § 28(a) remains in force until 1987 (unless the Naval Appropriation Act remains operative).

TRA-86, § 1277(c)(2) renders any pre-1987 taxable year an open year for Virgin Islands inhabitant taxpayers, including Danbury, according to the IRS.²

This condition exists because, with very few exceptions, Virgin Islands inhabitants, properly filed their returns and paid their income tax to the Virgin Islands Government as required under the ROA § 28(a) inhabitant rule — not to the United States Treasury. Because no returns were filed or tax paid to the United States, the IRS says the statute of limitations has never begun to run.

The IRS may therefore audit the returns and assess tax against every Virgin Islands inhabitant taxpayer

² At the request of the judicial panel hearing oral argument, the Third Circuit asked the Commissioner of Internal Revenue to file a brief which is included herein as Appendix E, page 59a, *infra*.

back to 1935 as observed by the Third Circuit. Appendix B, page 39a, *infra*. Such retroactive tax legislation is constitutionally invalid. *U.S. v. Hudson*, 299 U.S. 498 (1937).

Danbury's 1981 and 1982 income taxes, if any, are properly payable to the Virgin Islands, and the Third Circuit remand should be reversed.

VI

THE THIRD CIRCUIT INCORRECTLY DECIDED THAT THE "PRE-1987 OPEN YEAR" EFFECTIVE DATE WAS "ADMIN- ISTRATIVE" AND NOT SUBSTANTIVE.

To support its argument validating the retroactive pre-1987 open year effective date for revocation of the ROA § 28(a) inhabitant rule, the Third Circuit wrongly decided that the retroactive effective date was *administrative* and did not effect Danbury's tax liability — it only identified the payee as either the Virgin Islands or the United States Treasury — not the amount of anyone's tax, according to the Third Circuit's decision. Appendix B, page 36a, fn. 4, *infra*.

This so-called administrative provision changes Danbury's 1981 and 1982 income taxes from *none* to \$97,750.00 and \$240,607.00, respectively, as claimed by the BIR which hardly seems administrative.

This is a substantive open-ended retroactive tax provision which violates long established tenants of tax law and should be invalidated by this Court. *U.S. v. Hudson*, *supra*.

The Third Circuit has devised a whole new and novel dual tax determination theory and incorrectly concluded that Danbury must make two income tax computations:

First: As a U.S. domestic corporation under the U.S. Internal Revenue Code (herein "USIRC"), referred to by the Third Circuit as the "literal Code," (and also as the "non-mirrored Code"), and

Then: As a Virgin Islands inhabitant foreign corporation under the Virgin Islands Internal Revenue Code (herein "VIIRC"), which is the USIRC, referred to by the Third Circuit as the "mirror Code" under the mirror system.

(As discussed earlier herein, page 7, the Third Circuit has imposed the USIRC on Virgin Islands inhabitants, e.g. Danbury, without any Congressional enactment or authority. The Courts are without constitutional authority to enact tax laws.)

The sum of these two taxes, less a credit against the United States income tax for foreign income tax paid to the Virgin Islands, is then paid to the BIR or the IRS under the Third Circuit decision. Appendix B, page 29a, *infra*.

The Third Circuit overlooked the fact that the income tax regulations deny Virgin Islands inhabitants such a credit. The U.S. Income Tax Regulations provide that "(a)mong those to whom the credit for taxes is *not* allowed are the following: . . .

(5) . . . persons who are inhabitants of the Virgin Islands. . . ." (Emphasis added) Reg. § 1.901-1(g).

In a Third Circuit case decided little more than two weeks after the *Danbury* decision, Judge Rosenn, who sat on the *Danbury* panel and participated in the *Danbury* decision observed and quoted Reg. § 1.901-1(g) denying the foreign tax credit on United States income tax returns to Virgin Islands inhabitants. See *Johnson v. Quin*, 821 F.2d 212. Of course, the reason that the Regulations deny Virgin Islands inhabitants a credit against the United States income tax is that such inhabitants are not required to pay any United States income tax. Under ROA § 28(a), they pay their income tax under the mirror system to the Virgin Islands. Without such a credit, under the Third Circuit dual tax determination theory, taxpayers, e.g. *Danbury*, would have a large double tax which in *Danbury's* case would be \$97,750.00 and \$240,607.00 for 1981 and 1982, respectively.³

The tax results advocated by the Third Circuit and the BIR are not the same. The Third Circuit expresses the view that the BIR method of computing the Virgin Islands income tax is just a shorthand method of the Court's determination. Appendix B, page 29a, *infra*. This is wrong.

Obviously, the effective date of TRA-86, § 1275(b) revoking the ROA § 28(a) inhabitant rule is much more than administrative and has a large substantive impact on the income tax determination.

³ Pursuant to TRA-86, § 1275(a), amending IRC § 936, if a domestic corporation can meet specific restrictive requirements, a credit will be available for certain possession activities in Puerto Rico and the Virgin Islands. *Danbury* does not meet the activities requirements.

VII

**THE RETROACTIVITY OF § 1277(c)(2) IS
ADMINISTRATIVE AND DOES NOT VIO-
LATE CONSTITUTIONAL PRINCIPLES,
OR CONTRA,
THE IRS' UNLIMITED RETROACTIVITY
POSITION IS INVALID.**

The Third Circuit opinion on the retroactivity of the “any pre-1987 open years” effective date is a direct contradiction which should be corrected.

First, the Third Circuit said:

“Contrary to Danbury’s assertions, this case does not involve retroactive taxation if the Tax Reform Act is found to apply to Danbury’s 1981 and 1982 tax years. Section 7651 changes only the *administration* of the United States tax in the Virgin Islands. It does not alter the amount of tax owed by any taxpayer.” (Emphasis added) Appendix B, page 36a, fn. 4, *infra*.

Then, in response to the IRS’ argument that § 1277(c)(2) opens every pre-1987 year, Appendix E, page 72a, *infra*., the Third Circuit says:

“Were we to accept the Internal Revenue Service’s argument that sub-section 6501(c)(3) does apply to this case, every tax year since 1935 for every Virgin Islands inhabitant would be an open year. (Footnote omitted) Congress obviously did not intend such a result. If it had, the complex time provisions of Section 1277(c)(2) would not

have been enacted; Congress would have simply declared Section 1275(b) to be effective for all tax years." Appendix B, page 39a, *infra*.

If § 1277(c)(2) is administrative, then how is the IRS barred from assessment for "... every tax year since 1935 for every Virgin Islands inhabitant ..."? On the other hand, if the IRS is barred from assessment back to 1935, how can § 1277(c)(2) be anything but substantive, and as the Third Circuit wrongly concludes "... does not alter the amount of tax owed by any taxpayer."

Either § 1277(c)(2) is administrative and all post-1935 years are open years, or it is not administrative, but substantive, and appropriate statutes of limitation apply.

Under the Third Circuit theory, TRA-86 § 1277(c)(2) is administrative, but nevertheless the applicable statutes of limitation effectively run. Thus, if Danbury is subject to United States income tax as the Court decided, the three (3) year statute of limitations will run against the United States Treasury because it has not delivered a ninety (90) day letter to Danbury for 1981 and 1982. The Third Circuit ruled that Danbury's filing with the BIR is effective to start the statute running against the United States Treasury in spite of the fact that no returns were filed with the IRS. Appendix B, page 39a, *infra*.

VIII

THE *DANBURY* DECISION AND PRIOR DECISIONS OF THE THIRD CIRCUIT ARE IN CONFLICT AND DISARRAY CAUSING CHAOS FOR VIRGIN ISLANDS INHABITANTS IN THE DETERMINATION OF THEIR INCOME TAXES.

Trying to fashion a decision to satisfy its sense of equity, the Third Circuit now denies that the VIIRC is the exclusive income tax law of the Virgin Islands and contradicts all of its prior decisions and one subsequent decision holding that:

“ . . . we are satisfied that the tax here in dispute is actually not a tax of the United States but a territorial income tax. . . .

“The tax thus imposed by the Naval Appropriation Act was explained in Congress as providing for local imposition upon the inhabitants of the Virgin Islands of a territorial income tax, payable directly into the Virgin Islands treasury, to assist the Islands in becoming self-supporting. (Footnote omitted) The enactment was recommended as following the precedent of earlier legislation applying to Puerto Rico and the Philippines. (Footnote omitted) That purpose has been consistently implemented by both the federal and territorial taxing authorities, who have recognized that Congress created a local, locally collectible income tax and that the United States and the Virgin

Islands are distinct taxing jurisdictions although their income tax laws arise from an identical statute applicable to each. Internal Revenue rulings, the first of which was issued over twenty years ago, have taken this view. I.T. 2946, XIV-2 C.B. 109 (1935); I.T. 3690, 1944 C.B. 164. The correctness of this official interpretation and practice appears never heretofore to have been questioned, and the income tax has been administered in the Virgin Islands in accordance with this construction for over a generation. Such a settled administrative construction applied in a multitude of cases over an extended period is entitled to great weight." (Citations omitted)

Dudley v. Commissioner of Internal Revenue, supra, at pages 184, 185.

See also the following cases citing and following the *Dudley* case.

In the case of *HMW Industries, Inc. v. Wheatley*, supra, page 150, the Third Circuit said:

"As we recognized in *Dudley v. Commissioner of Internal Revenue*, 258 F.2d 182 (3d Cir. 1958), the purpose behind the enactment of the Naval Appropriation Act was to impose 'upon the inhabitants of the Virgin Islands . . . a territorial income tax, payable directly into the Virgin Islands treasury, to assist the Islands in becoming self-supporting.' 258 F.2d at 185. Thus, the effect of the above quoted provisions was to create a separate taxing structure for the Virgin Islands

‘mirroring’ the provisions of the federal tax code except as to those provisions which are incompatible with such a separate tax structure.” (Citations omitted)

In the case of *Pan American World Airways, Inc. v. Virgin Islands*, 459 F.2d 387, 391, fn. 2, the Third Circuit said:

“In the Naval Service Appropriation Act of 1922, 48 U.S.C. § 1397, Congress enacted a territorial income tax which is a mirror image of the current federal income tax. See *Chicago Bridge and Iron Co. v. Wheatley*, 430 F.2d 973 (3d Cir. 1970). The income tax is, however, a territorial tax collected, not by the Internal Revenue Service, but by the territorial revenue officers. *Dudley v. Commissioner of Internal Revenue*, 258 F.2d 182 (3d Cir. 1970). The income tax is, however, a territorial tax collected, (sic) has paid Virgin Islands income taxes and that the apportionment of income tax between the United States and the Virgin Islands is not questioned.”

Quoting the Naval Appropriation Act of 1921, in the case of *Chicago Bridge and Iron Co. v. Wheatley*, supra, page 973, the Third Circuit said:

“Beyond merely extending the geographic coverage of the Internal Revenue Code, this statute in effect created a separate territorial income tax measured by that Code and to be collected by the Government of the Virgin Islands. *Dudley v. Commissioner of Internal Revenue*, 3d Cir. 1958, 258 F.2d 182, 185.”

As Judge Rosenn wrote in the case of *Johnson v. Quin*, supra, at page 213:

“As we have explained in the earlier cases, Congress neither passed a separate income tax law for the Virgin Islands nor permitted its legislature to do so. Instead, Congress provided that the provisions of United States income tax law should be used in the tax code of the Virgin Islands with necessary nomenclature changes to make them effective, that is, ‘Virgin Islands’ should be substituted for ‘United States’ whenever appropriate. The United States and the Virgin Islands are two separate and distinct taxing authorities, and the revenue due the Virgin Islands is paid into its treasury. This resulted in what has been called the ‘mirror system’ of taxation. For a history and general description of its operation, see *Dudley v. Commissioner of Internal Revenue*, 258 F.2d 182, 3 V.I. 685 (3d Cir. 1958); *Chicago Bridge and Iron Co. v. Wheatley*, 430 F.2d 973, 7 V.I. 555 (3d Cir. 1970), cert. denied, 401 U.S. 910, 91 S.Ct. 873, 27 L.Ed.2d 809 (1971); and *Great Cruz Bay, Inc., St. John, Virgin Islands v. Wheatley*, 495 F.2d 301, 11 V.I. 189 (3d Cir. 1974). *Vitco, Inc. v. Government of the Virgin Islands*, 560 F.2d 180, 181-82 (3d Cir. 1977), cert. denied, 435 U.S. 980, 98 S.Ct. 1630, 56 L.Ed.2d 72 (1978). Virgin Islands residents discharge their United States tax liability by payment of all income taxes to the Virgin Islands, under section 28(a) of Revised Organic Act of 1954, 48 U.S.C. § 1642, which provides in pertinent

part, [T]he proceeds of the United States income tax . . . shall be covered into the treasury of the Virgin Islands, and shall be available for expenditure as the Legislature of the Virgin Islands may provide: *Provided*, That the term 'inhabitants of the Virgin Islands' as used in this section shall include all persons whose permanent residence is in the Virgin Islands, and such persons shall satisfy their income tax obligations under applicable taxing statutes of the United States by paying their tax on income derived from all sources both within and outside the Virgin Islands into the treasury of the Virgin Islands"

The IRS has ruled that:

"Section 28(a) of the Revised Organic Act of the Virgin Islands (R.O.A.), 48 U.S.C. section 1642 (Supp. 1979), makes substantial changes in this system as it affects 'inhabitants of the Virgin Islands.' Section 28(a) requires inhabitants to satisfy their United States and Virgin Islands income tax obligations arising under Chapter 1 of the Code (as applicable in each jurisdiction) by filing a single return with, and paying to, the Virgin Islands the Virgin Islands territorial income tax (the Code as mirrored into the Virgin Islands) on their income from all sources. See Rev. Rul. 60-291, 1960-2 C.B. 407." Revenue Ruling 80-40, *supra*.

Twenty-nine years after its decision in the *Dudley* case, the Third Circuit has rejected its holding that the

Virgin Islands income tax is a territorial income tax determined under the mirror system and that the United States and the Virgin Islands are distinct taxing jurisdictions. Instead the Third Circuit now views the tax determination of Virgin Islands inhabitants as a bifurcated process imposing the United States income tax on all of the Virgin Islands inhabitant taxpayers' worldwide income, and a distinct and separate Virgin Islands territorial income tax on the taxpayers' Virgin Islands source income.

The Third Circuit rejection of the *Dudley* case was accomplished by ignoring this landmark decision, and without the benefit of any discussion distinguishing the cases, or even any citation thereto.

This newly created taxing plan upsets many years of established tax practice. It will cause unnecessary labor and confusion for Virgin Islands taxpayers without Virgin Islands source income or who are uncertain as to the source of their income.

IX

THE VIRGIN ISLANDS BIR IS WITHOUT AUTHORITY TO IMPOSE, ENFORCE AND COLLECT A UNITED STATES INCOME TAX.

Under its dual tax computation theory, the Third Circuit has imposed United States income tax upon Virgin Islands inhabitants, including inhabitant corporations, e.g. Danbury, in addition to the VIIRC. The Third Circuit has previously denied the BIR the right to enforce such a tax. *Dudley v. Commissioner*, supra at page 188, where the Court said:

“ . . . we think that it is clear, contrary to the taxpayer’s contention, that Congress did not intend . . . to bring territorial officers of the Virgin Islands into the federal Internal Revenue Service or to change the pre-existing law in any relevant respect. These officers are not appointed by nor under the control or authority of the Secretary of the Treasury nor are they his delegates. They are territorial and not federal officers. *Harris v. Boreham*, 3 Cir., 1956, 233 F.2d 110.”

Under the Third Circuit’s dual tax system the BIR could not issue a ninety (90) day letter or appear in Tax Court to enforce an assessment under the USIRC. With respect to a ninety (90) day letter issued by the BIR, the Third Circuit ruled in the *Dudley* case:

“Accordingly it is clear from the face of the petition and the alleged deficiency letters annexed thereto, that the deficiency here sought to be redetermined was not claimed by the Commissioner of Internal Revenue or by any officer of the United States. The Tax Court was, therefore, correct in ruling that the alleged notice of deficiency was not issued by the Secretary of the Treasury or his delegate. Since, as we have seen, the jurisdiction of the Tax Court is limited to redetermining deficiency determinations made by officers of the United States, namely, the Secretary or his delegate, with respect to certain specified taxes, the Court did not err in holding that it did not have jurisdiction in

this case." *Dudley v. Commissioner*, supra, page 184.

Under the USIRC, only the Treasury Secretary and his delegates may issue a ninety (90) day letter. USIRC, § 6212(a). The Third Circuit decided in the *Dudley* case that a territorial official of the Virgin Islands is not such a delegate who may issue a ninety (90) day letter under USIRC, and that the United States Tax Court is without jurisdiction over tax assessments by Virgin Islands officials under the VIIRC. *Dudley v. Commissioner*, supra, page 184.

X

THE DANBURY DECISION RESTORES DISCREDITED LAW.

Prior to 1935, as the Third Circuit observed, the U.S. Treasury Department and the IRS treated the Virgin Islands as a "collection district" for United States taxes rather than a separate tax jurisdiction under the Naval Appropriation Act. Appendix B, page 24a, *infra*. Subsequent to 1935 the U.S. Treasury and the IRS have recognized the Virgin Islands as a separate tax jurisdiction with its own territorial income tax under the mirror system.

However, under the dual tax determination theory advocated by the Third Circuit in *Danbury*, the Virgin Islands BIR is again relegated to the role of a collector of the U.S. income tax, under the so-called literal Code, as the Third Circuit describes it. Appendix B, page 28a, *infra*.

XI

WHY DID CONGRESS CHANGE THE LAW — THE THIRD CIRCUIT'S VIRGIN ISLANDS DUAL TAX THEORY IS WRONG.

Tens of thousands of Virgin Islands inhabitants have been making a single income tax computation, have filed a single return, and paid a single tax, at least since the enactment in 1954 of ROA § 28(a).

The creative Third Circuit dual tax determination theory is contrary to the rules of the IRS, Revenue Ruling 80-40, *supra*, and inconsistent with the published views of the BIR. "Tax Structure of the U.S. Virgin Islands," Appendix F, page 81a, *infra*.

The Government of the Virgin Islands has lured Danbury (and a multitude of other corporations) to the Virgin Islands by publishing the following statement:

"Corporation Income Taxes

"What has been said covering the individual income tax is, in the main, applicable to corporations. A domestic corporation, for Virgin Islands income tax purposes, is one which is organized under the laws of the Virgin Islands. A foreign corporation is one which is not organized here.

"A domestic corporation pays income taxes on its worldwide income to the V.I. Treasury (Form 1120). *A foreign corporation pays V.I. income taxes only on its V.I. source income (Form 1120F).*"

At least sixty (60) inhabitant Virgin Islands taxpayers situated in a manner similar to Danbury have made a single tax computation and filed a single return with the BIR according to the BIR.⁴ The Third Circuit wrongly argues that its dual tax construction is consistent with what the BIR advocated in *Danbury* as a shorthand way of arriving at Danbury's Virgin Islands income tax, i.e., merely treat it as domestic to the Virgin Islands and apply the mirrored code. Appendix B, page 29a, *infra*.

Why did Congress enact the Virgin Islands provisions of TRA-86 and change the law, revoking ROA § 28(a) if it did not agree with *Danbury* and the District Court concerning the Virgin Islands tax law?

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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⁴ The BIR used this number in its brief before the Third Circuit.

APPENDIX A

**Memorandum Opinion of the District Court
of the Virgin Islands, Filed January 24, 1986**

APPENDIX A
IN THE DISTRICT COURT OF
THE VIRGIN ISLANDS
DIVISION OF ST. CROIX

DANBURY, INC.)	
A Nevada Corporation)	
)	
<i>Petitioner,</i>)	
)	
vs.)	
)	
ANTHONY OLIVE,)	CIVIL NO.
Director)	1985/269
Bureau of Internal Revenue)	
Government of the)	
Virgin Islands)	
)	
<i>Respondent.</i>)	
_____)	

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DAVID V. O'BRIEN, Judge

MEMORANDUM OPINION
(Filed January 24, 1986)

We are presented here with the prospect of the ultimate tax shelter. Can a United States corporation headquartered in the Virgin Islands avoid paying income tax to both governments? Under the facts of this case, we hold that, by the use of a loophole in the taxing statutes, it can.

I. INTRODUCTION

Before discussing the specifics of this case, an initial introduction is needed to provide an understanding of the Court's approach to interpretation of tax statutes, as well as a further understanding of the relationship of the United States Internal Revenue Code to the Virgin Islands.

A. Interpretation of a Tax Statute

It is a cardinal rule of statutory construction that when the language of a statute is clear, a court should look no farther than those words in interpreting the statute. *E.g., Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 201 (1976). The United States Supreme Court has long applied this rule with equal force to matters involving

the Internal Revenue Code ("I.R.C."). In *Gould v. Gould*, 245 U.S. 151 (1917), the Court stated:

In the interpretation of statutes levying taxes it is the established rule not to extend their provisions, by implication, beyond the clear import of the language used, or to enlarge their operations so as to embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the government, and in favor of the citizen. (Citations omitted).

Id. at 153.

Thus, we are constrained to interpret and enforce the tax laws as Congress has enacted them. We may neither re-write the statutes nor divine an interpretation that is inconsistent with their clear language. And this rule applies despite the most absurd results. *White v. United States*, 305 U.S. 281, 292 (1938); *Estate of Cowser v. Commissioner of Internal Revenue*, 736 F.2d 1168, 1171 (7th Cir. 1984). *Accord Commonwealth Edison Company v. Montana*, 453 U.S. 609, 628 (1981); *United States v. Noall*, 587 F.2d 123, 126 (2d Cir. 1978) *cert denied* 441 U.S. 923 (1979).

B. The Mirror Theory

The Virgin Islands tax code is a mirror image of the I.R.C.. The genesis of this system is the Naval Service Appropriation Act of 1922, 48 U.S.C. § 1397 (Supp. 1985) which provides:

*Income tax laws of the United States in force;
payment of proceeds; levy of surtax on all
taxpayers*

The income-tax laws in force in the United States of America and those which may hereafter be enacted shall be held to be likewise in force in the Virgin Islands of the United States, except that the proceeds of such taxes shall be paid into the treasuries of said islands

This law established the Virgin Islands as a separate tax jurisdiction. *Vitco, Inc. v. Government of the Virgin Islands*, 560 F.2d 180, 181-82 (3d Cir. 1977) *cert denied* 435 U.S. 980 (1978); *Chicago Bridge and Iron Co. v. Wheatley*, 430 F.2d 973, 975-76 (3d Cir. 1970) *cert denied* 401 U.S. 910 (1971). The I.R.C. and its regulations are adapted by substituting "Virgin Islands" in place of "United States". *Vitco, supra* at 181-82; *Chicago Bridge, supra* at 974-75. Apart from making non-substantive changes in nomenclature, however, the Virgin Islands has no power to enact tax laws or amend the I.R.C.. *Chicago Bridge, supra* at 975-76.

Consequently, our analysis is limited to the provisions of the I.R.C. as amended under the mirror theory.¹

II. THE UNDISPUTED FACTS

The petitioner, Danbury, Inc., is an investment corporation owned equally by two shareholders, John M. Aschieris and M. Douglas. Since its creation in 1980, Danbury has acted solely as a holding company

¹ For clarity's sake, we will make the transposition of "United States" to "Virgin Islands" in the applicable statutes throughout this opinion.

for the shareholders' investments. It was organized under the laws of Nevada and, consequently, is a foreign corporation for Virgin Islands tax purposes.² As is required by its certificate of incorporation, Danbury is headquartered and maintains its only office in the Virgin Islands. Until its records were seized by federal treasury agents in May, 1984, all corporate documents were maintained here. Additionally Danbury has a local bank account and, pursuant to its by-laws, holds its shareholder and director meetings in the Virgin Islands.

This corporate presence qualifies Danbury as a Virgin Islands inhabitant for tax purposes.³ It also distinguishes it from the post office box variety shell corporation.

Danbury reported gross earnings of \$782,175.55 to the Virgin Islands for the 1981-82 tax years.⁴ The income was attributed to:

² 26 U.S.C. §§ 7701(4)-(5). A foreign corporation is one not organized under the laws of the Virgin Islands.

³ The Revised Organic Act defines inhabitants as "persons whose permanent address is in the Virgin Islands." 48 U.S.C. § 1642 (Supp. 1985). "Persons" includes corporations. *Vitco*, *supra* at 183. The *Vitco* Court also held that a mere post office box is sufficient to establish the requisite permanent residence. *Id.* at 183.

⁴ Virgin Island inhabitants, such as Danbury, satisfy their federal tax obligations by filing a single return with the territory's Bureau of Internal Revenue. 48 U.S.C. § 1642. The operation of this statute will be discussed in detail *infra*.

	1981	1982
Limited partnership distributions	\$203,528.00	\$355,655.00
Interest income	52,590.00	168,826.05
Loss from sale of diamonds	—	(1,576.50)
total	\$256,118.00	\$526,057.55

Both sources of income are located in the United States. Danbury claimed that all but \$96,985.00 of its 1982 earnings was exempt and paid a \$26,243.00 tax. It paid no tax on the 1981 income. The Government, however, found that the income in both years was taxable in its entirety and assessed deficiencies against Danbury of \$97,750.00 and \$240,607.00 for the respective years.

Danbury now moves for summary judgment. Its tax shelter is simply explained. Danbury is both a foreign corporation and an inhabitant of the Virgin Islands because it is not organized under the territory's laws but maintains its headquarters here. As an inhabitant it must pay tax on its world-wide income to the Virgin Islands' treasury. Foreign corporations, however, are taxed only on income derived in the Virgin Islands. Since Danbury's income is wholly generated from foreign sources, it owes no tax to the Virgin Islands. And because its United States obligations are satisfied under the Virgin Islands tax code, it owes no tax to the federal government.⁵

⁵ Both the federal and territorial governments have been aware since at least 1980 of this quirk in the law. *Tax Management*, published by The Bureau of National Affairs, Inc., issued "Business Operations in the U.S. Virgin Islands", T.M. 336-2nd (1980), which precisely describes the loophole. Congress has considered its elimination several times, most recently in President

On the basis of this scheme, Danbury requests that we invalidate the deficiencies.

The Government, in its cross-motion for summary judgment, argues that Danbury should be treated as a domestic corporation and taxed on its world-wide income.

III. DISCUSSION

The Virgin Islands collects taxes from two sources: inhabitants and non-inhabitant foreign entities. Inhabitants are taxed under the authority of 48 U.S.C. § 1642 (Supp. 1985) which provides:

Use of certain proceeds for expenditure; income tax obligations of inhabitants

The proceeds of customs duties, the proceeds of the United States income tax [and] the proceeds of any taxes levied by the Congress on the inhabitants of the Virgin Islands . . . shall be covered into the treasury of the Virgin Islands, and shall be available for expenditure as the Legislature of the Virgin Islands may provide: *Provided*, That the term "inhabitants of the Virgin Islands" as used in this section shall include all persons

Reagan's 1985 tax reform package. See "The President's Tax Proposals to the Congress for Fairness, Growth and Simplicity", May, 1985, pp. 423-31. At oral argument, the Court was advised that income from hundreds of millions of dollars of corporate assets is currently being sheltered under the Danbury loophole. The Virgin Islands Bureau of Internal Revenue has challenged the tax returns of these foreign corporations in each instance. The Danbury case is the first of those filed in District Court to reach the level of judicial determination.

whose permanent residence is in the Virgin Islands, and such persons shall submit their income tax obligations under applicable taxing statutes of the United States by paying their tax on income derived from all sources both within and outside the Virgin Islands

....

Simply stated, permanent residents pay tax on their world-wide income to the territory and in so doing they fulfill their federal tax obligations. *See Vitco, supra* at 182.

Non-inhabitant foreign entities, on the other hand, are taxed only on the income they derive in the Virgin Islands. By substituting "Virgin Islands" for the "United States" as required under the mirror theory, 26 U.S.C. § 882 provides in pertinent part:

Tax on income of foreign corporations connected with Virgin Islands business

(a) *Imposition of tax*

(1) *In general.*—A foreign corporation engaged in trade or business within the Virgin Islands during the taxable year shall be taxable as provided in section 11 or 1201(a) on its taxable income which is effectively connected with the conduct of a trade or business within the Virgin Islands.

(2) *Determination of taxable income.*—In determining taxable income for purposes of paragraph (1), gross income includes only gross income which is effectively connected with the conduct of a trade or business within the Virgin Islands.

(b) *Gross Income*—In the case of a foreign corporation, gross income includes only—

(1) gross income which is derived from sources within the Virgin Islands and which is not effectively connected with the conduct of a trade or business within the Virgin Islands and

(2) gross income which is effectively connected with the conduct of a trade or business within the Virgin Islands.

Corporations organized in the 50 states pay tax on their world-wide income to the federal treasury but, to avoid double taxation, they receive a foreign tax credit for the taxes paid to the Virgin Islands. *Chicago Bridge, supra* at 974.

As a hybrid, Danbury claims the benefits of both § 1642 and § 882. The result, of course, is that its income is tax exempt. We will examine each claim separately.

A. The § 882 Exemption

As a general rule, the income that a foreign corporation derives from stateside sources cannot be taxed by the Virgin Islands.⁶ Section 882 provides that a corporation will be taxed, however, on income derived from a locally conducted trade or business or any other local source. And otherwise exempt income will be taxed, nevertheless, if the Virgin Islands office

⁶ We will discuss the impact of 48 U.S.C. § 1642 on this general rule *infra*.

is a material factor in generating the income. 26 U.S.C. § 864(c)(4)(B).⁷

Although the Government concedes that § 882 applies to Danbury, we will satisfy ourselves as to whether Danbury is entitled to this exemption.

Two factors can be eliminated in short order. First, we can safely assume that Danbury located its headquarters in the Virgin Islands solely to exploit a fluke in the tax laws. The locale in no way contributed to the generation of its income. Moreover, the income clearly originated from mainland investments. The trade or business element, however, requires more consideration.

In order for a taxpayer to claim business or trade status on the basis of investment activity, the taxpayer must be an active investor. *E.g., Higgins v. Commissioner of Internal Revenue*, 312 U.S. 212, 216-17 (1940);

⁷ The statute provides in pertinent part:

(B) Income, gain, or loss from sources without the Virgin Islands shall be treated as effectively connected with the conduct of a trade or business within the Virgin Islands by a nonresident alien individual or a foreign corporation if such person has an office or other fixed place of business within the Virgin Islands to which such income, gain, or loss is attributable and such income, gain, or loss— . . .

(iii) is derived from the sale or exchange (without the Virgin Islands) through such office or other fixed place of business of personal property described in section 1221(1), except that this clause shall not apply if the property is sold or exchanged for use, consumption, or disposition outside the Virgin Islands and an office or other fixed place of business of the taxpayer outside the Virgin Islands participated materially in such sale or exchange.

Snyder v. Commissioner of Internal Revenue, 295 U.S. 134, 139 (1934). Active investors spend the majority of their time speculating in securities. *Snyder, id.*

Under this rule, we need not discuss whether Danbury's activities qualify as a trade or business. They obviously do not. The sources of the income are by definition synonymous with passivity. The corporation is merely a receptacle for interest income and limited partnership distributions. Thus, we conclude that Danbury is not engaged in a trade or business and hold that Danbury is entitled to the § 882 exemption.

B. The effect of § 1642 on the Internal Revenue Code

The remaining obstacle—and the Government's sole defense—to Danbury's tax shelter is the effect of 48 U.S.C. § 1642 (text quoted *supra*) on the I.R.C. in general and on § 882 specifically.

The Government, in its motion for summary judgment, asserts that § 1642 authorizes the Virgin Islands to dispense with the source distinction of § 882 and tax a foreign corporation as if it were domestic. The Government's first theory is this: the plain language of § 1642 indicates that it is a taxing statute, separate from the I.R.C., which allows the territory to alter the mirror of § 882. The operative language is "inhabitants . . . shall satisfy their income tax obligations . . . by paying their tax *on income derived from all sources both within and without the Virgin Islands* into the treasury of the Virgin Islands." (emphasis added).

At the onset, we disagree with the Government's premise that § 1642 authorizes it to alter the definition of a domestic corporation. By limiting the

Government's income taxing authority to the execution of non-substantive changes in nomenclature, the Third Circuit has implicitly held that § 1642 is not a taxing statute. See *Chicago Bridge, supra* at 975-76. We hold, therefore, that the Government may not tailor the provisions of the I.R.C. to suit the situation. It is bound, as we are, to enforce the statutes as enacted by Congress. *E.g., Ernst, supra; Gould, supra; White, supra.* The I.R.C. concisely defines foreign and domestic corporations,⁸ and the Government may not dispense with these definitions, even where the alternative is the ultimate tax shelter.

In so holding, we decline to follow Rev. Ruling 80-40, the Government's sole authority for this theory. Although the subject corporation there was conducting business in the Virgin Islands, the facts of Rev. Ruling 80-40 are otherwise on point with Danbury's tax shelter. The ruling holds, under the purported authority of § 1642, that the corporation should be taxed as a domestic corporation. This ruling must be rejected as suffering from the same malady as the Government's argument. It merely states a conclusion and the fact that the result is desired is simply not enough. To paraphrase the First Circuit, we find that "attaching the label [tax shelter] is not the end of analysis. We cannot decide this case simply by saying 'No'. We have a duty to explain ourselves and to set out a rule of law to govern future cases." *Textron, Inc. v. United States*, 561 F.2d 1023, 1027 (1st Cir. 1977).

The Government argues next that the source distinctions of § 882 conflict with and are, therefore, vitiated by § 1642 because the latter gives to the Virgin

⁸ 26 U.S.C. § 7701(4)-(5).

Islands the authority to tax "income derived from all sources." In essence the Government contends that § 1642 precludes the mirroring of I.R.C. provisions, such as § 882 which constrain its ability to tax anything less than all income. To accept this argument is to invite the opening of a Pandora's box as to all of the I.R.C.'s tax reducing provisions such as the § 162 trade and business deduction and the § 101 exclusion of life insurance proceeds. And this we will not do.

The phrase quoted by the Government must be considered in the context of the statute. It mandates that inhabitants "shall satisfy their income tax obligations *under applicable tax statutes of the United States* by paying their tax on income derived from all sources" to the territory's treasury. (emphasis added). The Government persistently urges us to ignore the key words of § 1642 emphasized above. This language means nothing more than that the I.R.C. is the tax code of the Virgin Islands, an interpretation that is consistent with, and mandated by, the mirror law. 48 U.S.C. § 1397 (Supp. 1985).

It is true that § 1642 broadly defines taxable income. In this respect it is similar to the I.R.C.'s general definition of income: "gross income means all income from whatever source derived." 26 U.S.C. § 61. But it cannot be suggested with a straight face that § 61 prohibits a taxpayer from claiming exemptions, exclusions and deductions authorized by the I.R.C. Yet the Government would have us hold that § 1642 has precisely this effect. In effect, the Virgin Islands seeks to pick and choose which sections of the I.R.C. it will honor.

Like § 61, § 1642 is a general rule of inclusion and, as such, it is subject to all of the provisions of the

I.R.C. — including § 882—authorizing exceptions to that rule.

Finally, we find nothing in the legislative history of § 1642 to give credence to the Government's position. Prior to the enactment of § 1642, Virgin Islands residents were taxed by both the federal and territorial government according to the source of their income. The statute abolished the source distinction by introducing a single filing requirement. The purpose was to increase the Virgin Islands' tax revenues by subjecting to local taxation both the local and mainland income of the residents. S. Rep. No. 1271 83d Cong., 2d Sess. 2, *reprinted in* 1954 U.S. Code Cong & Ad. News 2585 *et seq.*

But there is nothing to suggest that Congress intended to allow the Virgin Islands to chip away at the mirror theory so carefully retained over all these years. Rather, it appears that the effect of § 882 in favor of a foreign corporation inhabitant filing in the Virgin Islands was overlooked. We cannot legislate the closing of this loophole by judicial fiat. To do so would encroach on prerogatives in tax matters delegated to the executive and legislative branches of government.

We hold then, that § 1642 simply provides the basic tax procedure for territorial inhabitants who derive income from either or both Virgin Islands and foreign sources. It has no independent effect on the provisions of the I.R.C.

IV. CONCLUSION

We hold that the deficiencies assessed against Danbury were improper because the corporation's income is exempt from taxation under 26 U.S.C. § 882.

We are not, however, deciding this case in a vacuum. Danbury was organized for the specific purpose of exploiting a gap in the tax laws—a gap that is truly the ultimate tax shelter. We are certain that Congress did not intend to create this aperture in the tax laws.⁹ But where one occurs it is the exclusive province of Congress and the federal chief executive to close it. And until this is accomplished, a corporation may pursue the Danbury route.

DATED this 24th day of January, 1986.

⁹ The loophole discussed in this opinion is not the only anomaly which results from the mirror system. In President Reagan's 1985 proposals for tax reform mentioned in footnote 5, it states at page 426:

"... the mirror system gives rise to numerous areas of ambiguity and problems of interpretation. These technical difficulties have made administration of the law problematic, created a climate of uncertainty for investors, and raised the possibility of unintended tax benefits for some and harsh consequences for others."

IN THE DISTRICT COURT OF
THE VIRGIN ISLANDS
DIVISION OF ST. CROIX

DANBURY, INC.)
A Nevada Corporation)
)
Petitioner,)
)
vs.)
)
ANTHONY OLIVE,)
Director)
Bureau of Internal Revenue)
Government of the)
Virgin Islands)
)
Respondent.)
_____)

CIVIL NO.
1985/269

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DISTRICT COURT
ST. CROIX, VI.

SUMMARY JUDGMENT

THIS MATTER is before the Court upon the cross-motions of the parties for summary judgment. The Court having filed its Memorandum Opinion of even date herewith, and the premises considered, now therefore it is

ORDERED, ADJUDGED and DECREED:

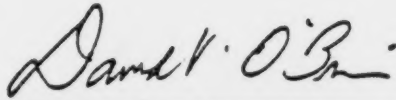
THAT the motion of the petitioner for summary judgment be, and the same is hereby GRANTED and further

THAT the motion of the respondent for summary judgment be, and the same is hereby DENIED and further

THAT the deficiencies assessed by the Virgin Islands Bureau of Internal Revenue for the years 1981 and 1982 against the petitioner be, and the same are hereby INVALIDATED.

DATED this 24th day of January, 1986.

ENTER:

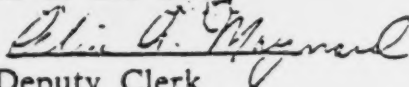


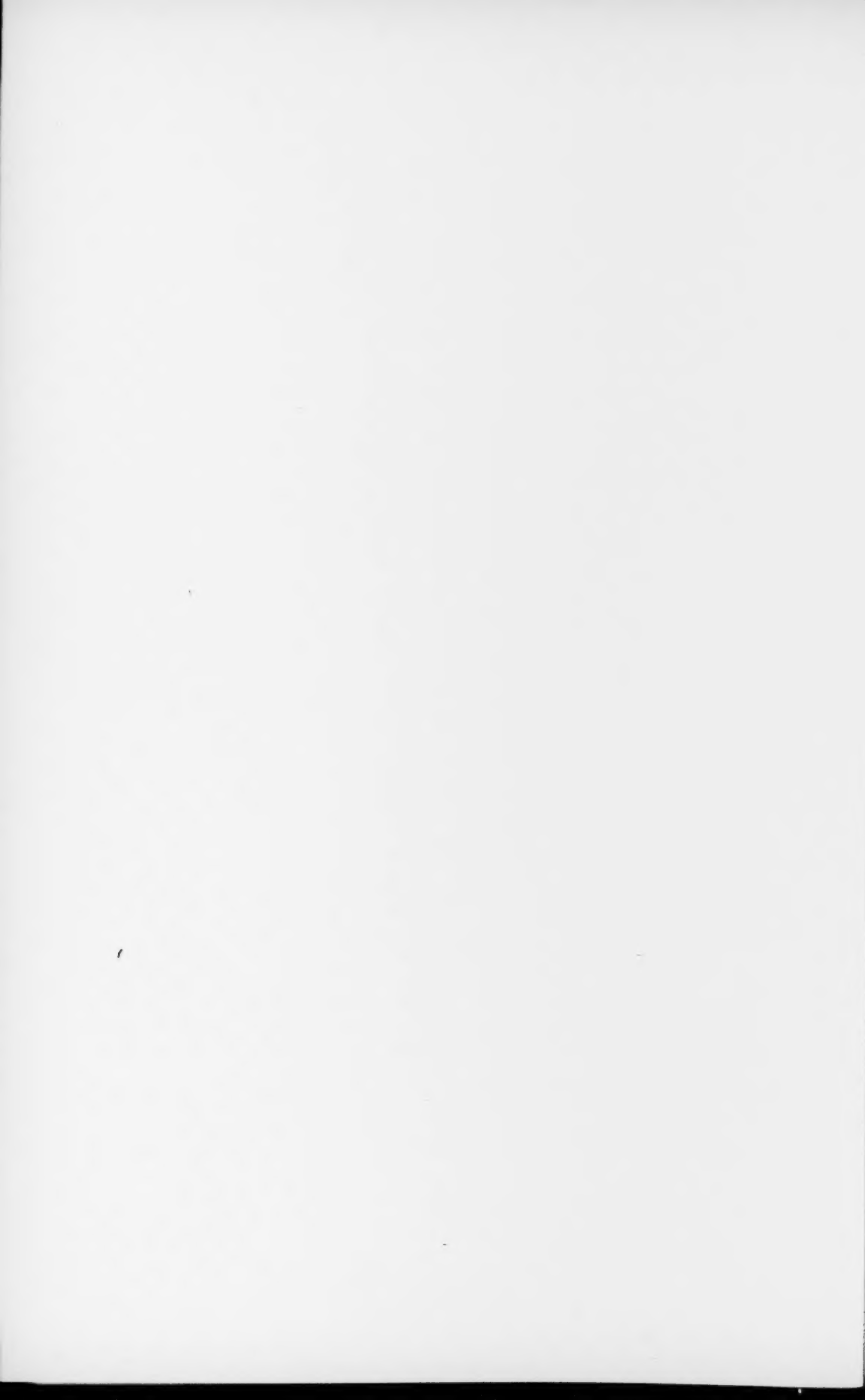
DAVID V. O'BRIEN, Judge

ATTEST:

GEOFFREY BARNARD

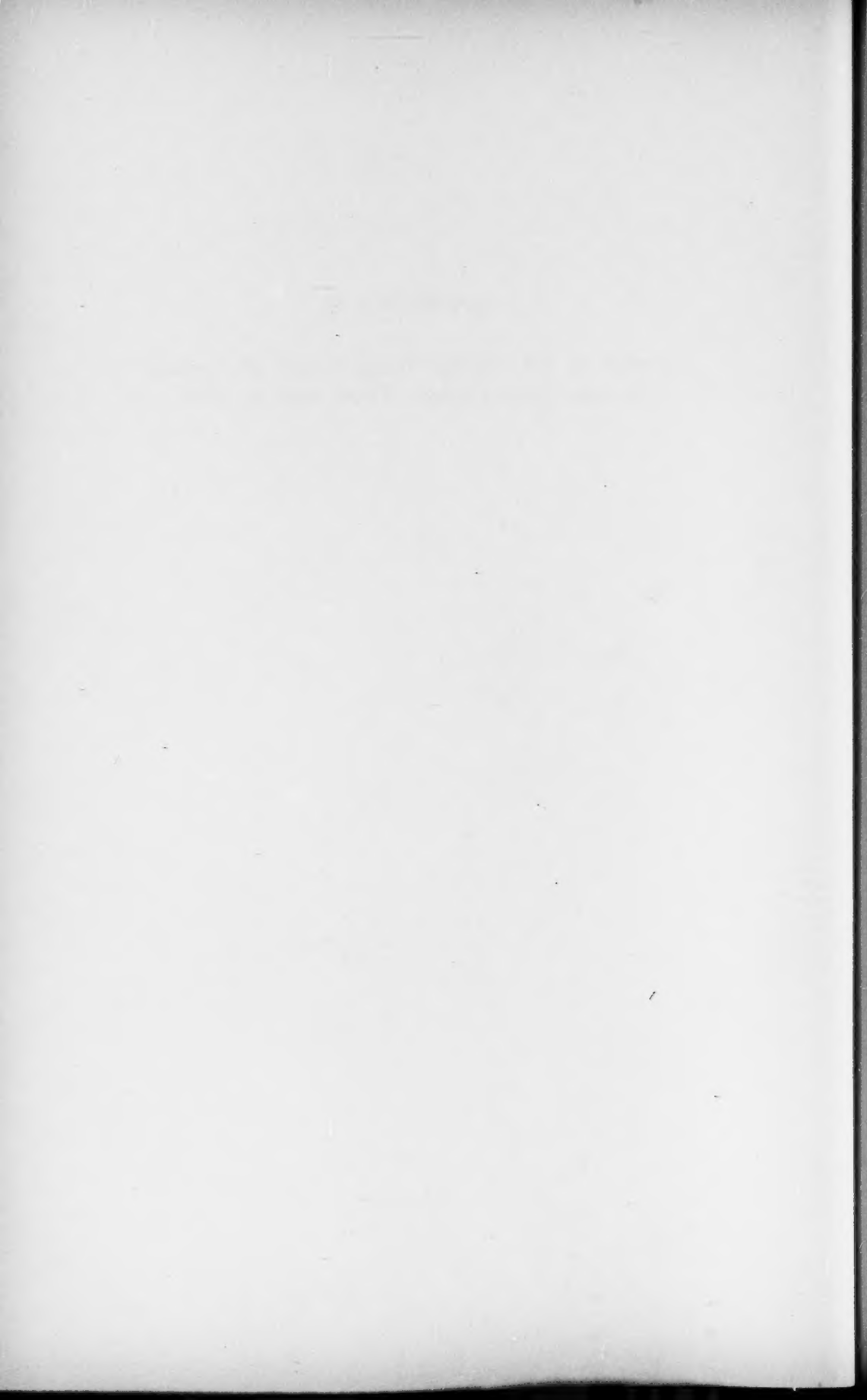
Clerk of the Court

By: 
Deputy Clerk



APPENDIX B

**Opinion of the United States Court of Appeals
for the Third Circuit, Filed June 5, 1987**



APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 86-3091

DANBURY, INC.

Appellee

v.

ANTHONY OLIVE, DIRECTOR
BUREAU OF INTERNAL REVENUE
GOVERNMENT OF THE VIRGIN ISLANDS

Appellant

On Appeal from the United States
District Court of the
Virgin Islands, Division of St. Croix
(Civil Action No. 85-269)

Argued December 2, 1986

BEFORE: SLOVITER, STAPLETON, and ROSENN,
Circuit Judges
(Opinion Filed JUNE 5, 1987)

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STAPLETON, J., *Circuit Judge*

Danbury, Inc. ("Danbury"), a Nevada corporation that maintains its sole office in the Virgin Islands, instituted this litigation by filing a "Petition for Redetermination of Alleged Income Tax Deficiency" in the District Court of the Virgin Islands. The Virgin Islands' Bureau of Internal Revenue ("the BIR") appeals from a January 24, 1986, district court decision that granted summary judgment to Danbury.

The district court erroneously concluded that the tax law then applicable in the Virgin Islands to a corporation such as Danbury did not support the deficiencies alleged by the BIR. Furthermore, on October 22, 1986, the Tax Reform Act of 1986 ("the Tax Reform Act") became law. We will reverse and remand the case for consideration of whether the tax years at issue here, 1981 and 1982, are "pre-1987 open years" for Danbury, as that phrase is used in the Tax Reform Act.

I.

The facts underlying this dispute are simple and uncontested. Danbury is a holding company for the investments of its two shareholders. Although incorporated under the laws of Nevada, Danbury keeps all its corporate documents at its sole office in the Virgin Islands, maintains a Virgin Islands bank account, and holds all its shareholders' and directors' meetings in the islands.

On September 15, 1982, Danbury filed its income tax return for the year 1981 with the BIR, disclosing income of \$256,118. The corporation paid no tax. On July 1, 1983, Danbury filed its return for the year 1982

with the BIR, disclosing "taxable income" of \$96,985 and other income of \$526,057.55. Danbury paid the BIR \$26,243. The income on which Danbury did not pay tax, \$256,118 in 1981 and \$526,057.55 in 1982, came from sources outside the Virgin Islands that were not part of a Virgin Islands trade or business. Danbury did not file an income tax return for either 1981 or 1982 with the Internal Revenue Service of the United States.

On September 4, 1985, the BIR notified Danbury that it had found a \$97,750 tax deficiency for 1981 and a \$240,607 deficiency for 1982. The deficiency notice referred Danbury to 48 U.S.C. section 1642, stating that under this statute "foreign corporations such as yourself are taxed just as if you were a domestic corporation and satisfy both your U.S. and V.I. income tax obligation by paying V.I. income tax on your income from allsources." App. at 14.

Pursuant to title 33, section 943(a) of the Virgin Islands Code and 28 U.S.C. section 1612(a), Danbury filed suit in the District Court of the Virgin Islands to contest the asserted deficiencies. Danbury's complaint claimed that no additional tax was due because the applicable tax statute did not require it to pay tax on its income from sources outside the Virgin Islands and because collection of additional tax by the BIR was barred by waiver, estoppel, and limitations. Danbury apparently dropped its waiver, estoppel, and limitations arguments during oral argument in the district court. The district court decided the remaining issue on cross-motions for summary judgment. *See Danbury, Inc. v. Olive*, 627 F.Supp. 513 (D.V.I. 1986).

II.

To understand the particular statutory provisions relevant here, one must have some general knowledge of the evolution of income tax law in the Virgin Islands since Denmark ceded the islands to the United States in 1917. At the outset, therefore, we briefly describe this evolution.

An act of Congress in 1917 continued the force and effect of all local laws imposing taxes, so far as compatible with the change in sovereignty, until Congress provided otherwise. Act of Mar. 3, 1917, ch. 171, § 4, 39 Stat. 1133 (codified as amended at 48 U.S.C.A. § 1395 (West 1952)). Then in the Naval Appropriations Act of 1921, Congress declared that the income tax laws of the United States also constitute the income tax laws of the Virgin Islands, with the proceeds from the laws, when they function as Virgin Islands laws, to be paid into the treasury of the Virgin Islands rather than the treasury of the United States. Naval Appropriations Act of 1921, ch. 44, § 1, 42 Stat. 123 (codified as amended at 48 U.S.C.A. § 1397 (West Supp. 1987)); *see also* V.I. Code Ann., tit. 33, § 1931(15) (1967). This 1921 statute set up the "mirror tax" system that remains in use: "Virgin Islands" is in effect substituted for "United States" (and vice versa) in the Internal Revenue Code so that, to satisfy Virgin Islands tax obligations, an individual or corporation in the Virgin Islands pays taxes to the BIR equivalent to the taxes an individual or corporation under the same circumstances in the United States would pay to the Internal Revenue Service. *See, e.g., HMW Industries, Inc. v. Wheatley*, 504 F.2d 146, 150 (3d Cir. 1974) (Congress "create[d] a separate taxing structure for the Virgin Islands 'mirroring' the provisions of the

federal tax code except as to those provisions which are incompatible with such a separate tax structure”); *Vitco, Inc. v. Government of Virgin Islands*, 560 F.2d 180, 185 (3d Cir. 1977) (substantive equality of treatment between mainland taxpayer and Virgin Islands taxpayer is goal of mirror system), *cert. denied*, 435 U.S. 980 (1978).

The U.S. Treasury Department and the Internal Revenue Service did not immediately implement the mirror system despite the clear language of the 1921 statute. Until 1935, these agencies treated the Virgin Islands as a “collection district” for United States taxes, rather than recognizing the distinct tax jurisdiction that the islands constitute according to the Naval Appropriations Act. See I.T. 1454, 1-2 C.B. 180 (1922), *revoked by* I.T. 2946, XIV-2 C.B. 109 (1935). Under the collection district approach, all taxpayers with attachments to both locations filed only one return, either in the Virgin Islands or the United States, depending upon where the taxpayer resided on the last day of the tax year.

When the mirror system was actually implemented in 1935, some taxpayers were required to file two returns. For example, a corporation considered “domestic” in the United States but doing business as a foreign corporation in the Virgin Islands was required to submit a return to the BIR, paying tax on income from sources in the Virgin Islands, and to submit a return to the Internal Revenue Service, paying tax on worldwide income, with a foreign tax credit allowed for the tax paid to the Virgin Islands. The mirror system, with its two separate taxing jurisdictions, operated similarly for citizens of the United States who resided in the Virgin Islands. *Cf. Chicago Bridge & Iron Co. v.*

Wheatley, 430 F.2d 973, 974 & n. 1 (3d Cir. 1970) (even after 1954, non-inhabitant U.S. citizens or U.S.-chartered corporations that earned income from a source in the Virgin Islands were required to file two returns; situation changed in 1954 for permanent residents), *cert. denied*, 401 U.S. 910 (1971). Section 28(a) of the 1954 Revised Organic Act of the Virgin Islands ("Section 28(a)") altered the post-1935 administration of the tax laws as follows:

The proceeds of customs duties, the proceeds of the United States income tax, the proceeds of any taxes levied by the Congress on the inhabitants of the Virgin Islands, and the proceeds of all quarantine, passport, immigration, and naturalization fees collected in the Virgin Islands . . . shall be covered into the treasury of the Virgin Islands, and shall be available for expenditure as the Legislature of the Virgin Islands may provide: *Provided*, That the term "inhabitants of the Virgin Islands" as used in this section shall include all persons whose permanent residence is in the Virgin Islands, and such persons shall satisfy their income tax obligations under the applicable taxing statutes of the United States by paying their tax on income derived from all sources both within and outside the Virgin Islands into the treasury of the Virgin Islands

. . . .

Revised Organic Act of the Virgin Islands, ch. 558, § 28(a), 68 Stat. 508 (1954) (codified as amended at 48 U.S.C.A. § 1642 (West Supp. 1987)). In addition, Congress in 1954 enacted a section of the Internal Revenue Code that established:

For purposes of this title . . . Section 28(a) of the Revised Organic Act of the Virgin Islands shall be effective as if such section had been enacted subsequent to the enactment of this title.

26 U.S.C.A. § 7651(5)(B) (West 1967) (current version at 26 U.S.C.A. § 7651(5)(B) (West Sup. 1987)). These statutory provisions brought the relevant law to the point where it stood at the time of the district court's decision. We parse Section 28(a) and 26 U.S.C. § 7651(5)(B) below.

III.

An appeal from a summary judgment triggers plenary review by the court of appeals. See *Koshatka v. Philadelphia Newspapers, Inc.*, 762 F.2d 329, 333 (3d Cir. 1985). Our analysis begins with an application of the law in effect when the lower court granted summary judgment to Danbury. We will then turn to the impact of the Tax Reform Act.

Danbury's identity determines the tax laws that apply to the corporation. First, Danbury is a "domestic" corporation with respect to the tax laws of the United States, the non-mirrored Internal Revenue Code. See 26 U.S.C.A. § 7701(a)(4) (West Supp. 1987) (" 'domestic' when applied to a corporation . . . means created or organized in the United States or under the law of the United States or of any State"). With respect to the tax laws of the Virgin Islands, the mirrored Internal Revenue Code, Danbury is a "foreign" corporation. See *Vitco, Inc. v. Government of Virgin Islands*, 560 F.2d 180, 181 (3d Cir. 1977) (New York corporation is " 'foreign' for Virgin Islands tax purposes"), *cert. denied*, 435 U.S. 980 (1978); *Sayre &*

Company v. Riddell, 395 F.2d 407, 412 (9th Cir. 1968) (en banc) (under Guam's mirrored Internal Revenue Code, "a corporation organized in Guam is 'domestic' " and "a corporation organized elsewhere [i.e., in one of the United States] is 'foreign'"). Furthermore, the parties agree that Danbury qualifies as an "inhabitant" of the Virgin Islands as that term is used in Section 28(a).¹ This court pointed out in *Vitco*, *supra*, that "[i]nhabitants' includes corporations as well as natural persons." 560 F.2d at 182 (citation omitted). According to the record before us, Danbury's only presence, and thus its "permanent residence," is in the Virgin Islands. An "inhabitant" is one whose permanent residence is on the islands. 48 U.S.C.A. § 1642 (Section 28(a)).

There is no dispute that such a corporation, absent Section 28(a), would file two tax returns—one with the BIR and one with the Internal Revenue Service. This foreign corporation's gross income on the BIR return would include only:

- (1) gross income which is derived from sources within [the Virgin Islands] and which is not effectively connected with the conduct

¹ The Commissioner of Internal Revenue of the United States submitted a brief as *amicus curiae* on February 6, 1987, in response to this court's invitation to the Commissioner to express his views concerning the issues in this case. The Commissioner's brief asserts that "the United States would likely take the position that the taxpayer here was an inhabitant of the United States and not of the Virgin Islands." Commissioner's Brief at 4 n. 3. We must, however, rely on the facts as stipulated by the parties to resolve the questions now before us. The Commissioner has not formally intervened in this matter.

of a trade or business within [the Virgin Islands], and

(2) gross income which is effectively connected with the conduct of a trade or business within [the Virgin Islands].

26 U.S.C.A. § 882(b) (West Supp. 1987) (mirrored). As a domestic corporation, its gross income on the United States return would include its worldwide income. See 26 U.S.C.A. § 61 (West Supp. 1987) (“[e]xcept as otherwise provided in this subtitle, gross income means all income from whatever source derived”). From the respective gross income figures, the corporation would calculate its tax liability according to the appropriate version of the Code, the mirrored Code for the BIR return and the literal Code for the Internal Revenue Service return.

Section 28(a) does not affect the total amount of tax owed by such a corporation, but does direct the corporation to pay its total tax liability, under both the mirrored and non-mirrored versions of the Code, into the Virgin Islands treasury. The language of the section is unambiguous. Section 28(a) first states that “the proceeds of the United States income tax” collected in the Virgin Islands are to be “covered into the treasury of the Virgin Islands,” for spending by the Virgin Islands legislature rather than by Congress. It then provides that inhabitants “shall satisfy their income tax obligations under the applicable taxing statutes of the United States by paying their tax on income derived from all sources both within and outside the Virgin Islands” into the islands’ treasury. This proviso implements Congress’ stated goal of depositing proceeds from the U.S. income tax into the treasury of the Virgin Islands. “[I]ncome tax

obligations under the applicable taxing statutes of the United States” in Section 28(a) means just that—taxes owed under applicable provisions of the non-mirrored Internal Revenue Code.

Section 7651(5)(B) of the Internal Revenue Code, quoted above as it read from 1954 until enactment of the Tax Reform Act, functioned to make Section 28(a)’s proviso effective by eliminating an inconsistency. The language of the Internal Revenue Code (“this title”) speaks in terms of all United States taxpayers owing their United States taxes to the Internal Revenue Service. Section 7651(5)(B), however, enables Virgin Islands inhabitants to comply with Section 28(a) (requiring payment of United States taxes to the Virgin Islands) because, under Section 7651(5)(B), Section 28(a) is to be treated as if it were enacted after all of the Internal Revenue Code, thereby overriding the Code’s requirement of payment to the Internal Revenue Service.

Thus, looking at the applicable law prior to the Tax Reform Act, Danbury owed the BIR (1) Virgin Islands taxes on Virgin Islands-generated income, under the Naval Appropriations Act, and (2) U.S. taxes on worldwide income, figured with a tax credit for any Virgin Islands or other foreign taxes paid, under Section 28(a). As the BIR stated in its deficiency notice to Danbury, a shorthand way of arriving at the sum that will satisfy both the U.S. and Virgin Islands tax obligations for an inhabitant, U.S.-chartered corporation such as Danbury is to treat the corporation as if it were domestic in the Virgin Islands and then simply figure its liability under the mirrored Code.²

² The BIR does not argue that Section 28(a) actually amends the

Danbury here attempts to escape its tax liability under the Internal Revenue Code for 1981 and 1982 by mirroring the proviso of Section 28(a). The corporation would have us read “the applicable taxing statutes of the United States” as meaning “the *mirrored* Internal Revenue Code.” See Appellee’s Brief at 39-40.³ According to Danbury, this proper reading of Section 28(a) requires the filing of only a return with the BIR and the paying of only the tax owed as a foreign corporation under the mirrored Code. Danbury’s interpretation of Section 28(a) renders its income from sources outside the Virgin Islands tax-free in both the U.S. and the Virgin Islands taxing jurisdictions.

Danbury’s attempted change in the plain meaning of Section 28(a) is without foundation. Section 28(a) is not a taxing provision, but rather is part of comprehensive legislation that reorganized the administration of government in the Virgin Islands. Indeed, Danbury concedes that the section “is not a tax law.” Appellee’s

mirrored Code, altering the definition of gross income for a foreign corporation in the Virgin Islands. The BIR correctly explains that Section 28(a) results in United States and Virgin Islands taxes for Danbury, owed to the BIR, that can be calculated by treating the corporation *as if* it were a domestic corporation. The district court erred by viewing this case as an attempt by the BIR to amend the mirrored Code.

³ As an elaboration of the same argument, Danbury emphasizes that Section 28(a)’s reference to “tax on income derived from all sources both within and outside the Virgin Islands” should be construed as Virgin Islands tax figured only on the basis of income from the Virgin Islands for a foreign corporation such as Danbury. Danbury decries the “fail[ure] to distinguish between nontaxable receipts and taxable income” that it views as an error in the BIR’s reading, and this court’s reading, of Section 28(a). Appellee’s Brief at 17.

Brief at 21. Because Section 28(a) is not part of the Internal Revenue Code, it stands outside the mirror tax system and thus there is no basis for changing its explicit language. Danbury fails to recognize that a mirroring system merely upsets basic principles of statutory construction within a very limited scope—the scope of the statutes that are to apply in two jurisdictions. In this case, “[t]he income-tax laws in force in the United States of America” are also applied in the Virgin Islands, requiring interpreting courts to make some nomenclature changes. Naval Appropriations Act of 1921, *supra*; see also, V.I. Code Ann., tit. 33, § 1931(15) (“ ‘Virgin Islands income tax law’ means so much of the United States Internal Revenue Code as was made applicable to the Virgin Islands” by the Naval Appropriations Act). To construe Section 28(a), however, “the starting point is of course the language of the statute itself.” *National Freight, Inc. v. Larson*, 760 F.2d 499, 503 (3d Cir. 1985), *cert. denied*, 106 S. Ct. 228 (1985). As discussed above, the language of Section 28(a) clearly states that inhabitants of the Virgin Islands must pay their U.S. income taxes directly to the BIR.

It is important to point out that if Section 28(a) did extinguish inhabitants’ liability for U.S. taxes, Section 28(a) would be internally inconsistent. If the section’s proviso eliminates U.S. tax obligations for corporations such as Danbury and for U.S. citizens who permanently reside in the Virgin Islands, as under Danbury’s reading it would, the proviso eliminates “the proceeds of the United States income tax . . . collected in the Virgin Islands” referred to in the main clause of the section. Danbury has advanced no reason why Congress at the outset would give proceeds to the

Virgin Islands and then later in the same section make those proceeds disappear.

Moreover, much of Section 28(a) would be superfluous and much of its meaning left unstated according to Danbury's reading. Danbury asserts that the proviso means that all inhabitants, including foreign corporations, must pay their *Virgin Islands* taxes to the BIR. Read this way, the proviso merely reiterates what the Naval Appropriations Act had specified many years earlier. In addition, this reading erases any textual support for the proposition, also advanced by Danbury, that Section 28(a) extinguishes inhabitants' tax liability to the Internal Revenue Service. Danbury is left in the untenable position of citing a revenue ruling interpreting Section 28(a), the conclusion of which Danbury denounces (a conclusion consistent with this court's reading of the section), for the proposition that the corporation must only file a return with the BIR and need not file with the Internal Revenue Service. See Appellee's Brief at 12-13 (citing Revenue Ruling 80-40 for need to file only one return); *id.* at 18-19 (rejecting authority of Revenue Ruling 80-40). We discuss this revenue ruling in more detail below.

Were we to consider Section 28(a) ambiguous and therefore turn to extrinsic indications of its meaning, our reading—of inhabitants' liability to the BIR for U.S. taxes—would remain the same. The purpose of the Revised Organic Act "is to provide a new organic act, or basic charter of civil government, for the people of the Virgin Islands." S. Rep. No. 1271, 83d Cong., 2d Sess, *reprinted in* 1954 U.S. Code & Admin. News 2585, 2585. The legislative history indicates that one of the primary reasons for enacting a new charter was to increase the economic autonomy of the islands. The

Senate report notes concern for “unbalanced Federal budgets” as well as touting the bill as “a step forward toward the day when the Virgin Islands could be self-sustaining.” S. Rep. No. 1271, *supra*, at 2586. In light of this congressional mindset, we cannot accept Danbury’s interpretation of Section 28(a), an interpretation that results in the federal treasury giving up revenue (proceeds from the U.S. income tax) without bestowing that revenue on the Virgin Islands.

The Internal Revenue Service has explained its reading of Section 28(a) in Revenue Ruling 80-40, 1980-1 C.B. 175, and Revenue Ruling 60-291, 1960-2 C.B. 407. Revenue Ruling 80-40 states:

Section 28(a) requires inhabitants to satisfy their United States and Virgin Islands income tax obligations arising under Chapter 1 of the Code (as applicable in each jurisdiction) by filing a single return with, and paying to, the Virgin Islands the Virgins Islands territorial income tax (the Code as mirrored into the Virgin Islands) on their income from all sources.

1980-1 C.B. 175, 176. The ruling goes on to explain:

Congress, in section 28(a) of the R.O.A., made it clear that such income [income of an inhabitant, U.S.-chartered corporation coming from non-Virgin Islands sources] . . . would not escape taxation by using the words “paying their tax on *income derived from all sources both within and outside the Virgin Islands* into the Treasury of the Virgin Islands” (emphasis added). Thus in effect, S [an inhabitant, U.S.-chartered corporation] is taxed as if it were a Virgin Islands

corporation and satisfies both its United States and Virgin Islands income tax obligations by paying the Virgin Islands territorial income tax on its income from all sources.

Id. In Revenue Ruling 60-291, the Internal Revenue Service ruled that Section 28(a) required United States citizens domiciled in the Virgin Islands to pay the taxes imposed on them by the 1954 Internal Revenue Code into the Virgin Islands' treasury. Revenue rulings are "administrative in nature and do not have the force of law," *Becker v. Commissioner*, 751 F.2d 146, 149 (3d Cir. 1985), but here they do provide persuasive evidence of others reading Section 28(a) as this court reads it.

The only interpretation inconsistent with our reading that Danbury can produce, other than its own assertions, is found in a private publication, read mainly by tax lawyers, that describes the interpretation now argued by Danbury as a "tax haven theory." *Business Operations in the U.S. Virgin Islands*, Tax Mgmt. (BNA) No. 336-2d, at A-91 (1978). Danbury is the first taxpayer to raise the tax-loophole theory in court—over thirty years after Congress enacted the statute at the heart of Danbury's contentions. This attempt to avoid assessment of an income tax deficiency apparently arose from the "creative" analysis offered by the article in Tax Management, rather than from a rational consideration of the actual taxing and administrative statutes.

In sum, setting aside for the moment any possible impact of the Tax Reform Act, we conclude that the district court should have awarded the BIR summary judgment, for Danbury owed the Virgin Islands its taxes under both the literal and the mirrored versions

of the Internal Revenue Code. The facts of the taxpayer's situation are undisputed. The law, as it stood at the time of the lower court's decision, supported the BIR's notice of deficiency.

IV.

This court, however, must apply the law in effect when it resolves an appeal. The court will apply a statute passed after decision in the trial court if that law is a valid enactment. See *Thorpe v. Housing Authority*, 393 U.S. 268, 281-82 (1969). As Chief Justice Marshall explained almost two centuries ago,

[I]f subsequent to the judgment and before the decision of the appellate court, a law intervenes and positively changes the rule which governs, the law must be obeyed, or its obligation denied. If the law be constitutional, . . . I know of no court which can contest its obligation.

United States v. Schooner Peggy, 1 Cranch 103, 110 (1801), quoted in *Thorpe*, 393 U.S. at 282. Therefore, we now consider the instant dispute in light of the Tax Reform Act.

The new statute includes a provision entitled "Clarification of Treatment of the Virgin Islands Inhabitants." Tax Reform Act of 1986, Pub. L. No. 99-514, § 1275(b), 100 Stat. 2598 (1986). This provision, section 1275(b) of the Tax Reform Act ("Section 1275(b)"), amends 26 U.S.C. section 7651(5)(B) to read:

For purposes of this title, section 28(a) of the Revised Organic Act of the Virgin Islands shall be effective as if such section 28(a) had

been enacted before the enactment of this title and such section 28(a) shall have no effect on the amount of income tax liability required to be paid by any person to the United States.

26 U.S.C.A. § 7651(5)(B) (West Supp. 1987). Section 1275(b) thus repeals the “inhabitant rule” discussed above—the rule that inhabitants of the Virgin Islands satisfy tax obligations to the United States by paying those taxes to the Virgin Islands rather than to the Internal Revenue Service. Section 1275(b) restores the administration of the mirror tax system in the Virgin Islands to its 1935-1954 state. Under the new law, a corporation such as Danbury pays its taxes under the mirrored Code to the BIR and pays its taxes under the literal Code to the Internal Revenue Service.⁴

Section 1277(c)(2) of the Tax Reform Act (“Section 1277(c)(2)”) addresses when and how Section 1275(b) is to be implemented:

(A) In General.—The amendment made by section 1275(b) shall apply with respect to—

(i) any taxable year beginning after December 31, 1986, and

(ii) any pre-1987 open year.

(B) Special Rules.—In the case of any pre-1987 open year—

(i) the amendment made by section 1275(b) shall not apply to income from

⁴ Contrary to Danbury's assertions, this case does not involve retroactive taxation if the Tax Reform Act is found to apply to Danbury's 1981 and 1982 tax years. Section 7651 changes only the administration of the United States tax in the Virgin Islands. It does not alter the amount of tax owed by any taxpayer.

sources in the Virgin Islands or income effectively connected with the conduct of a trade or business in the Virgin Islands, and

(ii) the taxpayer shall be allowed a credit—

(I) against any additional tax imposed by subtitle A of the Internal Revenue Code of 1954 (by reason of the amendment made by section 1275(b)) on income not described in clause (i) and from sources in the United States.

(II) for any tax paid to the Virgin Islands before the date of the enactment of this Act and attributable to such income.

For purposes of clause (ii)(II), any tax paid before January 1, 1987, pursuant to a process in effect before August 16, 1986, shall be treated as paid before the date of the enactment of this Act.

(C) Pre-1987 Open Year.—For purposes of this paragraph, the term “pre-1987 open year” means any taxable year beginning before January 1, 1987, if on the date of the enactment of this Act the assessment of a deficiency of income tax for such taxable year is not barred by any law or rule of law.

Tax Reform Act of 1986, Pub. L. No. 99-514, § 1277(c)(2), *reprinted as note after* 26 U.S.C.A. § 931 (West Supp. 1987).

Applying the relevant enactments since the district court’s decision in this case, the crucial question becomes whether the years 1981 and 1982 are “pre-1987 open years” for Danbury. Section 1275(b) affects the case only if these years are open. The years are

open if on October 22, 1986, “the assessment of a deficiency of income tax for such taxable year is not barred by any law or rule of law.” Tax Reform Act of 1986, § 1277(c)(2).

To determine whether an assessment could be made on October 22, 1986, the relevant actor is the Internal Revenue Service. The clear purpose of Section 1277(c)(2) is to specify the tax years for which *the United States* can, under Section 1275(b), collect the taxes due it from Virgin Islands inhabitants. If on October 22, 1986, the United States could assess deficiencies in keeping with applicable statutes of limitation, Section 1275(b) empowers it to do so. Otherwise, Section 1275(b) is not effective, and the power to collect taxes owed by Virgin Islands taxpayers to the United States remains with the BIR for tax years prior to 1987.

The applicable time bars are found in section 6501 of the Internal Revenue Code. That section states:

(a) General Rule.—Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed)

. . . .

(c) Exceptions.—

(1) False return.—In the case of a false or fraudulent return with the intent to evade tax, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

(2) Willful attempt to evade tax.—In case of a willful attempt in any manner to defeat or evade tax imposed by this title . . . the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

(3) No return.—In the case of failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

26 U.S.C.A. § 6501 (West Supp. 1987). Sub-section 6501(e) extends the general three-year period for assessment or prosecution to six years if the taxpayer committed a “substantial omission of items.” 26 U.S.C.A. § 6501(e).

First, we hold that sub-section 6501(c)(3) does not apply here. Danbury did not fail to file returns for 1981 and 1982. At the appropriate filing time, Section 28(a) required Danbury to satisfy both its United States and Virgin Islands tax obligations by filing and paying in the Virgin Islands. Thus Danbury’s returns to the Virgin Islands satisfied its filing obligations under the literal Internal Revenue Code for the purpose of considering time bars. Were we to accept the Internal Revenue Service’s argument that sub-section 6501(c)(3) does apply to this case, every tax year since 1935 for every Virgin Islands inhabitant would be an open year.⁵ Congress obviously did not intend such a result. If it had, the complex time provisions of Section 1277(c)(2) would not have been enacted; Congress

⁵ As explained in note 1 of this opinion, the Commissioner of Internal Revenue has submitted a brief as *amicus curiae*.

would have simply declared Section 1275(b) to be effective for all tax years.

Sub-section 6501(e), with its six-year period for assessment, also appears not to apply in this case. Danbury apparently reported its entire 1981 and 1982 income on its returns.

The latest return at issue was filed on July 1, 1983, more than three years before October 22, 1986. Consequently, we hold that the "general rule" period of three years bars assessment of additional taxes against Danbury by the Internal Revenue Service. Therefore, the years at issue are "pre-1987 open years" only if Danbury has filed a false return, *see* 26 U.S.C.A. § 6501(c)(1), or made a willful attempt to evade tax, *see* 26 U.S.C.A. § 6501(c)(2).

It seems likely that, on remand, the BIR and Danbury will be willing to stipulate that Danbury has not engaged in such conduct. If so, we suggest that the district court provide an opportunity for the United States Commissioner of Internal Revenue to voluntarily intervene or be brought in by one or both of the current parties. If the Commissioner joins or is joined, all interested parties can have their rights determined in this suit and avoid unnecessary litigation. If the Commissioner does not become a party to this suit and the BIR and Danbury stipulate that the three-year limitations period is the one applicable to a given year, judgment should be entered for the BIR with respect to that year.

If for any reason there is a dispute on remand as to whether either year at issue is a "pre-1987 open year," the district court should consider the relevant evidence and resolve that dispute. As explained above, if one or both of the tax years are open, Section 1275(b) of the

Tax Reform Act applies and transfers assessment power from the BIR to the Internal Revenue Service. Thus, with respect to open years, the new statute prevents assessment by the BIR and Danbury is entitled to a judicial declaration of that fact, albeit for reasons other than those urged by it. Accordingly, if either year is found to be a “pre-1987 open year” within the meaning of Section 1277(c)(2) and Danbury continues to seek judicial intervention, the district court should enter an appropriate judgment in its favor.⁶

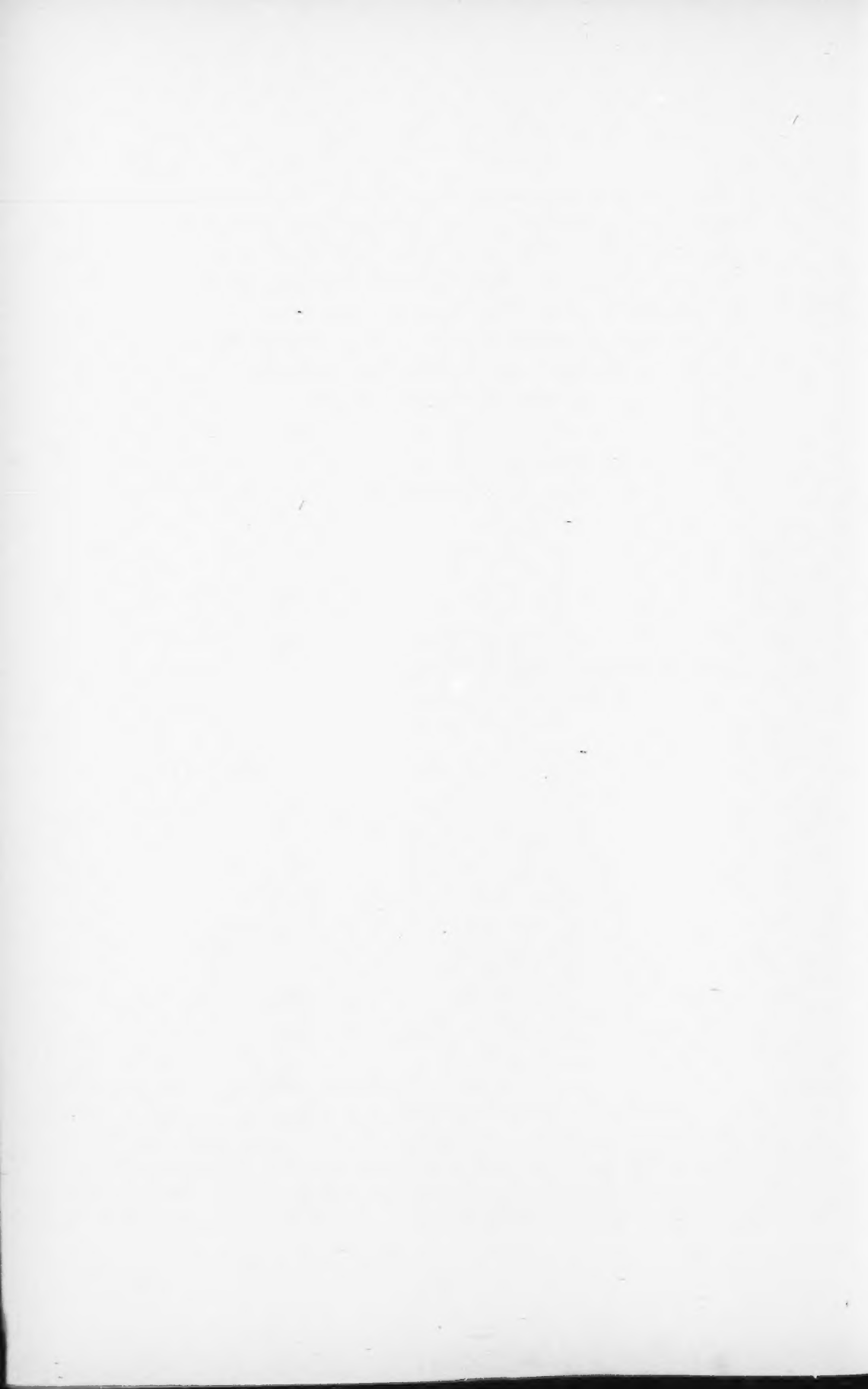
V.

We will reverse summary judgment entered for Danbury and remand this case to the district court for further proceedings consistent with this opinion.

⁶ We do not agree with the Commissioner’s contention that this case is now moot. After the passage of the Tax Reform Act, BIR has continued to assert that it is entitled to collect the assessed deficiencies and Danbury has continued to maintain that BIR is without authority to do so. Accordingly, this case remains a justiciable controversy.

APPENDIX C

**Sur Petition for Rehearing Denied by
United States Court of Appeals
for the Third Circuit**



APPENDIX C
UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 86-3091

DANBURY, INC.

Appellee

v.

ANTHONY OLIVE, DIRECTOR
BUREAU OF INTERNAL REVENUE
GOVERNMENT OF THE VIRGIN ISLANDS

Appellant

SUR PETITION FOR REHEARING

BEFORE: GIBBONS, *Chief Judge*, SEITZ, WEIS,
HIGGINBOTHAM, SLOVITER, BECKER, STAPLE-
TON, MANSMANN, AND ROSENN, *Circuit Judges*

The petition for rehearing filed by appellee in the above-entitled case having been submitted to the judges who participated in the decision of this Court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active

service not having voted for rehearing by the court in banc, the petition for rehearing is denied.

By the Court,

A handwritten signature in cursive script, appearing to read "Walter K. Stapleton", written over a horizontal line.

Circuit Judge

Dated: JUL 6 1927

APPENDIX D

**The Tax Reform Act of 1986
Section 1274, et seq.**



APPENDIX D
PART II — TREATMENT OF THE
VIRGIN ISLANDS

SEC. 1274. COORDINATION OF UNITED
STATES AND VIRGIN ISLANDS
INCOME TAXES.

(a) IN GENERAL. — Subpart D of part III of subchapter N of chapter 1 is amended by inserting after section 931 the following new section:

“SEC. 932. COORDINATION OF UNITED
STATES AND VIRGIN ISLANDS
INCOME TAXES.

“(a) TREATMENT OF UNITED STATES RESIDENTS. —

“(1) APPLICATION OF SUBSECTION. — This subsection shall apply to an individual for the taxable year if —

“(A) such individual —

“(i) is a citizen or resident of the United States (other than a bona fide resident of the Virgin Islands at the close of the taxable year), and

“(ii) has income derived from sources within the Virgin Islands, or effectively connected with the conduct of a trade or business within such possession, for the taxable year, or

“(B) such individual files a joint return for the taxable year with an individual described in subparagraph (A).

“(2) FILING REQUIREMENT. — Each individual to whom this subsection applies for the taxable year shall file his income tax return for the taxable year with both the United States and the Virgin Islands.

“(3) EXTENT OF INCOME TAX LIABILITY.— In the case of an individual to whom this subsection applies in a taxable year for purposes of so much of this title (other than this section and section 7654) as relates to the taxes imposed by this chapter, the United States shall be treated as including the Virgin Islands.

“(b) PORTION OF UNITED STATES TAX LIABILITY PAYABLE TO THE VIRGIN ISLANDS.—

“(1) IN GENERAL. — Each individual to whom subsection (a) applies for the taxable year shall pay the applicable percentage of the taxes imposed by this chapter for such taxable year (determined without regard to paragraph (3)) to the Virgin Islands.

“(2) APPLICABLE PERCENTAGE. —

“(A) IN GENERAL. —For purposes of paragraph (1), the term ‘applicable percentage’ means the percentage which Virgin Islands adjusted gross income bears to adjusted gross income.

“(B) VIRGIN ISLANDS ADJUSTED GROSS INCOME. — For purposes of subparagraph (A), the term ‘Virgin Islands adjusted gross income’ means adjusted gross income determined by taking into account

only income derived from sources within the Virgin Islands and deductions properly apportioned or allocable thereto.

“(3) AMOUNTS PAID ALLOWED AS CREDIT. — There shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to the taxes required to be paid to the Virgin Islands under paragraph (1) which are so paid.

“(c) TREATMENT OF VIRGIN ISLANDS RESIDENTS. —

“(1) APPLICATION OF SUBSECTION. — This subsection shall apply to an individual for the taxable year if —

“(A) such individual is a bona fide resident of the Virgin Islands at the close of the taxable year, or

“(B) such individual files a joint return for the taxable year with an individual described in subparagraph (A).

“(2) FILING REQUIREMENT. — Each individual to whom this subsection applies for the taxable year shall file his income tax return for the taxable year with the Virgin Islands.

“(3) EXTENT OF INCOME TAX LIABILITY.— In the case of an individual to whom this subsection applies in a taxable year for purposes of so much of this title (other than this section and section 7654) as relates to the taxes imposed by this chapter, the Virgin Islands shall be treated as including the United States.

“(4) RESIDENTS OF THE VIRGIN ISLANDS. — In the case of an individual who is a bona fide resident of the Virgin Islands at the close of the taxable

year and who, on his return of income tax to the Virgin Islands, reports income from all sources and identifies the source of each item shown on such return, for purposes of calculating income tax liability to the United States gross income shall not include any amount included in gross income on such return.

“(d) SPECIAL RULE FOR JOINT RETURNS. — In the case of a joint return, this section shall be applied on the basis of the residence of the spouse who has the greater adjusted gross income (determined without regard to community property laws) for the taxable year.

“(e) SECTION NOT TO APPLY TO TAX IMPOSED IN VIRGIN ISLANDS. — This section shall not apply for purposes of determining income tax liability incurred to the Virgin Islands.”

(b) AUTHORITY TO IMPOSE NONDISCRIMINATORY LOCAL INCOME TAXES. — Nothing in any provision of Federal law shall prevent the Virgin Islands from imposing on any person nondiscriminatory local income taxes. Any taxes so imposed shall be treated in the same manner as State and local income taxes under section 164 of the Internal Revenue Code of 1954 and shall not be treated as taxes to which section 901 of such Code applies.

(c) REGULATIONS ON APPLICATION OF MIRROR SYSTEM. — The Secretary of the Treasury or his delegate shall prescribe such regulations as may be necessary or appropriate for applying this title for purposes of determining tax liability incurred to the Virgin Islands.

(d) CLERICAL AMENDMENT. — The table of sections for such subpart D is amended by inserting

after the item relating to section 931 the following new item:

“Sec. 932. Coordination of United States and Virgin Islands income taxes.”

**SEC. 1275. VIRGIN ISLANDS
CORPORATIONS ALLOWED
POSSESSION TAX CREDIT.**

(a) POSSESSION TAX CREDIT ALLOWED. —

(1) **IN GENERAL.** — Paragraph (1) of section 936(d) (defining possession) is amended by striking out “, but does not include the Virgin Islands of the United States” and inserting in lieu thereof “and the Virgin Islands”.

(2) CONFORMING AMENDMENTS. —

(A) Section 934 is amended by striking out subsections (e) and (f).

(B) Subsection (e) of section 246 is amended by striking out “or 934(e)(3)”.

(b) CLARIFICATION OF TREATMENT OF VIRGIN ISLANDS INHABITANTS. — Subparagraph (B) of section 7651(5) (relating to the Virgin Islands) is amended to read as follows:

“(B) For purposes of this title, section 28(a) of the Revised Organic Act of the Virgin Islands shall be effective as if such section 28(a) had been enacted before the enactment of this title and such section 28(a) shall have no effect on the amount of income tax liability required to be paid by any person to the United States.”

(c) TECHNICAL AND CONFORMING AMENDMENTS. —

(1) Subsection 934 is amended by striking out subsections (b), (c), and (d).

(2)(A) Subsection (a) of section 934 is amended by striking out “or (c) or in section 934A”.

(B) Section 934, as amended by paragraph (1), is amended by inserting after subsection (a) the following new subsection:

“(b) REDUCTIONS PERMITTED WITH RESPECT TO CERTAIN INCOME.—

“(1) IN GENERAL. — Except as provided in paragraph (2), subsection (a) shall not apply with respect to so much of the tax liability referred to in subsection (a) as is attributable to income derived from sources within the Virgin Islands or income effectively connected with the conduct of a trade or business within the Virgin Islands.

“(2) EXCEPTION FOR LIABILITY PAID BY CITIZENS OR RESIDENTS OF THE UNITED STATES. — Paragraph (1) shall not apply to any liability payable to the Virgin Islands under section 932(b).

“(3) SPECIAL RULE FOR NON-UNITED STATES INCOME OF CERTAIN FOREIGN CORPORATIONS. —

“(A) IN GENERAL. — In the case of a qualified foreign corporation, subsection (a) shall not apply with respect to so much of the tax liability referred to in subsection (a) as is attributable to income which is derived from sources outside the United States and which is

not effectively connected with the conduct of a trade or business within the United States.

“(B) QUALIFIED FOREIGN CORPORATION. — For purposes of subparagraph (A), the term ‘qualified foreign corporation’ means any foreign corporation if less than 10 percent of —

“(i) the total voting power of the stock of such corporation, and

“(ii) the total value of the stock of such corporation, is owned or treated as owned (within the meaning of section 958) by 1 or more United States persons.

“(4) DETERMINATION OF INCOME SOURCE, ETC. — The determination as to whether income is derived from sources within the Virgin Islands or the United States or is effectively connected with the conduct of a trade or business within the Virgin Islands or the United States shall be made under regulations prescribed by the Secretary.”

(3) Section 934A (relating to income tax rates on Virgin Islands source income) is hereby repealed.

(4) Subparagraph (B) of section 28(d)(3) is amended to read as follows:

“(B) SPECIAL LIMITATION FOR CORPORATIONS TO WHICH SECTION 936 APPLIES. — No credit shall be allowed under this section with respect to any clinical testing conducted by a corporation to which an election under section 936 applies.”

(5) Clause (vii) of section 48(a)(2)(B) is amended by striking out “or which is entitled to the benefits of

section 934(b)” and by striking out “, 933, or 934(c)” and inserting in lieu thereof “or 933”.

(6) Clause (i) of section 338(h)(6)(B) is amended by striking out “a corporation described in section 934(b),”.

(7) Subparagraph (B) of section 864(d)(5) is amended to read as follows:

“(B) SPECIAL RULES FOR POSSESSIONS. — An amount treated as interest under paragraph (1) shall not be treated as income described in subparagraph (A) or (B) of section 936(a)(1) unless such amount is from sources within a possession of the United States (determined after the application of paragraph (1)).”

(8) The table of sections for subpart D of part III of subchapter N of chapter 1 is amended by striking out the item relating to section 934A.

PART III — COVER OVER OF INCOME TAXES

SEC. 1276. COVER OVER OF INCOME TAXES.

(a) IN GENERAL — Section 7654 (relating to coordination of United States and Guam individual income taxes) is amended to read as follows:

**“SEC. 7654. COORDINATION OF UNITED
STATES AND CERTAIN
POSSESSION INDIVIDUAL
INCOME TAXES.**

“(a) GENERAL RULE. — The net collection of taxes imposed by chapter 1 for each taxable year with respect to an individual to which section 931 or 932(c) applies shall be covered into the Treasury of the specified possession of which such individual is a bona fide resident.

“(b) DEFINITION AND SPECIAL RULE. — For purposes of this section —

“(1) NET COLLECTIONS. — In determining net collections for a taxable year, an appropriate adjustment shall be made for credits allowed against the tax liability and refunds made of income taxes for the taxable year.

“(2) SPECIFIED POSSESSION. — The term ‘specified possession’ means Guam, American Samoa, the Northern Mariana Islands, and the Virgin Islands.

“(c) TRANSFERS. — The transfers of funds between the United States and any specified possession required by this section shall be made not less frequently than annually.

“(d) FEDERAL PERSONNEL. — In addition to the amount determined under subsection (a), the United States shall pay to each specified possession at such times and in such manner as determined by the Secretary —

“(1) the amount of the taxes deducted and withheld by the United States under chapter 24 with respect to compensation paid

to members of the Armed Forces who are stationed in such possession but who have no income tax liability to such possession with respect to such compensation by reason of the Soldiers' and Sailors' Civil Relief Act (50 App. U.S.C. 501 et seq.), and

“(2) the amount of the taxes deducted and withheld under chapter 24 with respect to amounts paid for services performed as an employee of the United States (or any agency thereof) in a specified possession with respect to an individual unless section 931 or 932(c) applies.

“(e) REGULATIONS. — The Secretary shall prescribe such regulations as may be necessary to carry out the provisions of this section and sections 931 and 932, including regulations prohibiting the rebate of taxes covered over which are allocable to United States source income and prescribing the information which the individuals to whom such sections may apply shall furnish to the Secretary.”

(b) CLERICAL AMENDMENT. — The table of sections for subchapter D of chapter 78 is amended by striking out the item relating to section 7654 and inserting in lieu thereof the following:

“Sec. 7654. Coordination of United States and certain possession individual income taxes.”

PART IV — EFFECTIVE DATE

SEC. 1277. EFFECTIVE DATE.

(a) IN GENERAL. — Except as otherwise provided in this section, the amendments made by this subtitle shall apply to taxable years beginning after December 31, 1986.

(b) SPECIAL RULE FOR GUAM, AMERICAN SAMOA, AND THE NORTHERN MARIANA ISLANDS. — The amendments made by this subtitle shall apply with respect to Guam, American Samoa, or the Northern Mariana Islands (and to residents thereof and corporations created or organized therein) only if (and so long as) an implementing agreement under section 1271 is in effect between the United States and such possession.

(c) SPECIAL RULES FOR THE VIRGIN ISLANDS. —

(1) IN GENERAL. — The amendments made by section 1275(c) shall apply with respect to the Virgin Islands (and residents thereof and corporations created or organized therein) only if (and so long as) an implementing agreement is in effect between the United States and the Virgin Islands with respect to the establishment of rules under which the evasion or avoidance of United States income tax shall not be permitted or facilitated by such possession. Any such implementing agreement shall be executed on behalf of the United States by the Secretary of the Treasury, after consultation with the Secretary of the Interior.

(2) SECTION 1275(b). —

(A) IN GENERAL. — The amendment made by section 1275(b) shall apply with respect to —

(i) any taxable year beginning after December 31, 1986, and

(ii) any pre-1987 open year.

(B) SPECIAL RULES. — In the case of any pre-1987 open year —

(i) the amendment made by section 1275(b) shall not apply to income from sources in the Virgin Islands or income effectively connected with the conduct of a trade or business in the Virgin Islands, and

(ii) the taxpayer shall be allowed a credit

—

(I) against any additional tax imposed by subtitle A of the Internal Revenue Code of 1954 (by reason of the amendment made by section 1275(b)) on income not described in clause (i) and from sources in the United States,

(II) for any tax paid to the Virgin Islands before the date of the enactment of this Act and attributable to such income.

For purposes of clause (ii)(II), any tax paid before January 1, 1987, pursuant to a process in effect before August 16, 1986, shall be treated as paid before the date of the enactment of this Act.

(C) PRE-1987 OPEN YEAR. — For purposes of this paragraph, the term “pre-1987 open year” means any taxable year beginning before January 1, 1987, if on the

date of the enactment of this Act the assessment of a deficiency of income tax for such taxable year is not barred by any law or rule of law.

(D) EXCEPTION. — In the case of any pre-1987 open year, the amendment made by section 1275(b) shall not apply to any domestic corporation if —

(i) during the fiscal year which ended May 31, 1986, such corporation was actively engaged directly or through a subsidiary in the conduct of a trade or business in the Virgin Islands and such trade or business consists of business related to marine activities, and

(ii) such corporation was incorporated on March 31, 1983, in Delaware.

(E) EXCEPTION FOR CERTAIN TRANSACTIONS. —

(i) IN GENERAL. — In the case of any pre-1987 open year, the amendment made by section 1275(b) shall not apply to any income derived from transactions described in clause (ii) by 1 or more corporations which were formed in Delaware on or about March 6, 1981, and which have owned 1 or more office buildings in St. Thomas, United States Virgin Islands, for at least 5 years before the date of the enactment of this Act.

(ii) DESCRIPTION OF TRANSACTIONS. — The transactions described in this clause are —

(I) the redemptions of limited partnership interests for cash and property described in an agreement (as amended) dated March 12, 1981,

(II) the subsequent disposition of the properties distributed in such redemptions, and

(III) interest earned before January 1, 1987, on bank deposits of proceeds received from such redemptions to the extent such deposits are located in the United States Virgin Islands.

(iii) LIMITATION. — The aggregate reduction in tax by reason of this subparagraph shall not exceed \$8,312,000. If the taxes which would be payable as the result of the application of the amendment made by section 1275(b) to pre-1987 open years exceeds the limitation of the preceding sentence, such excess shall be treated as attributable to income received in taxable years in reverse chronological order.

(d) REPORT ON IMPLEMENTING AGREEMENTS. — If, during the 1-year period beginning on the date of the enactment of this Act, any implementing agreement described in subsection (b) or (c) is not executed, the Secretary of the Treasury or his delegate shall report to the Committee on Finance of the United States Senate, the Committee on Ways and Means, and the Committee on Interior and Insular Affairs of the House of Representatives with respect to —

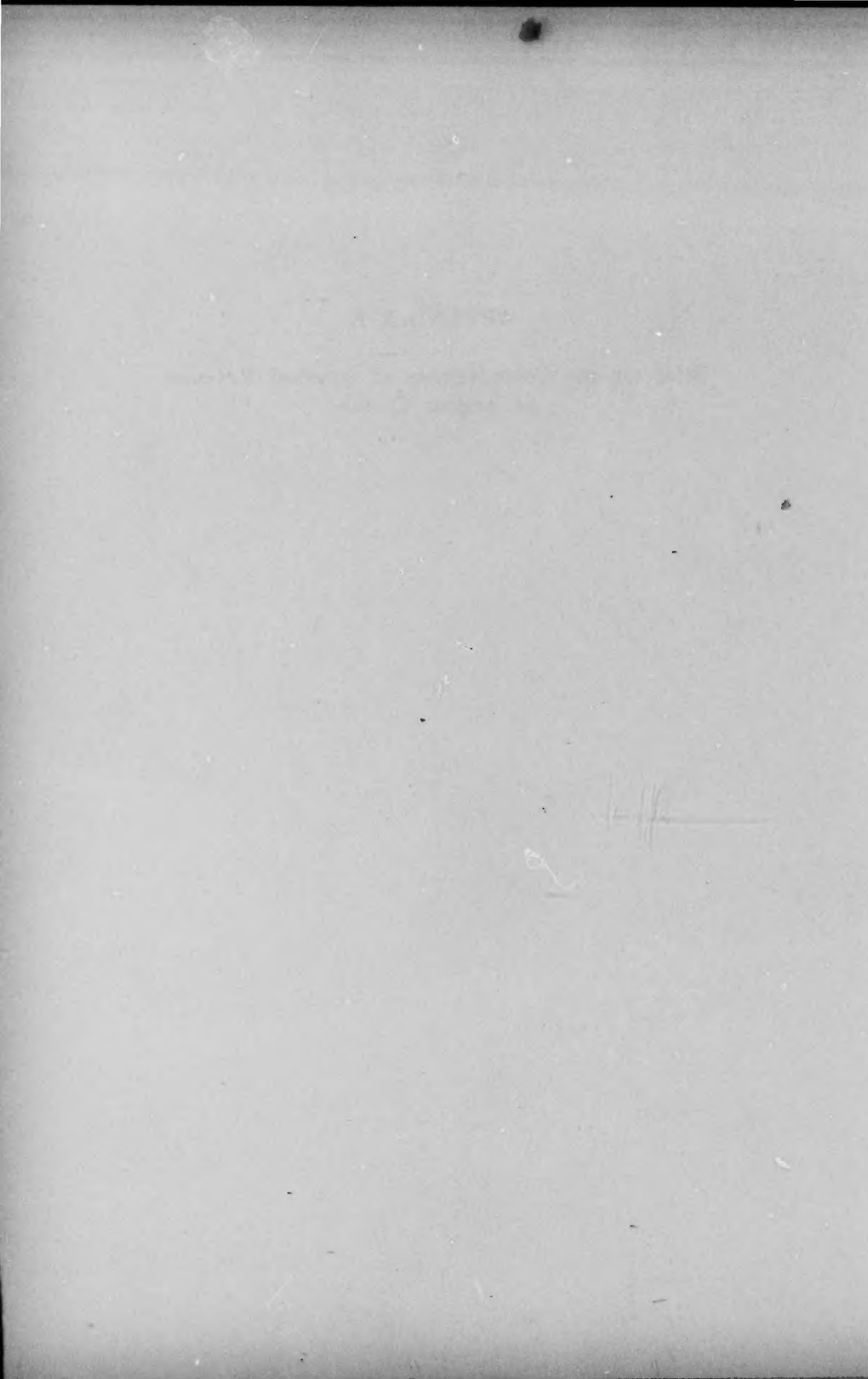
(1) the status of such negotiations, and

(2) the reason why such agreement has not been executed.

(e) TREATMENT OF CERTAIN UNITED STATES PERSONS. — Except as otherwise provided in regulations prescribed by the Secretary of the Treasury or his delegate, if a United States person becomes a resident of Guam, American Samoa, or the Northern Mariana Islands, the rules of section 877(c) of the Internal Revenue Code of 1954 shall apply to such person during the 10-year period beginning when such person became such a resident. The preceding sentence shall apply to dispositions after December 31, 1985, in taxable years ending after such date.

APPENDIX E

**Brief for the Commissioner of Internal Revenue
as Amicus Curiae**



APPENDIX E

NO. 86-3091

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

DANBURY, INC.

Petitioner-Appellee

v.

ANTHONY OLIVE, DIRECTOR
BUREAU OF INTERNAL REVENUE
GOVERNMENT OF THE VIRGIN ISLANDS

Respondent-Appellant

ON APPEAL FROM THE JUDGMENT OF THE
DISTRICT COURT OF THE VIRGIN ISLANDS

BRIEF FOR THE COMMISSIONER OF INTERNAL
REVENUE AS AMICUS CURIAE

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TABLE OF CONTENTS

	Page
Statement of subject matter and appellate jurisdiction	64a
Statement of the issue presented	65a
Statement of the case	65a
Statement of the facts	66a
Statement of related cases and proceedings	67a
Statement of the standard of review	67a
Summary of argument	68a
Argument:	
As a result of Section 1275(b) and 1277(c)(2)(B) of the Tax Reform Act of 1986, the case is moot	70a
Conclusion	78a

CITATIONS

Cases:

Canisius College v. United States, 799 F. 2d 18 (2d Cir. 1986)	75a, 78a
Chicago Bridge and Iron Co. v. Wheatley, 430 F. 2d 973 (3d Cir. 1970), cert. denied, 401 U.S. 910 (1971)	77a
County of Los Angeles v. Davis, 440 U.S. 625 (1979)	74a
Deakman-Wells Co. v. Commissioner, 213 F. 2d 894 (3d Cir. 1954)	73a
DeFunis v. Odegaard, 416 U.S. 312 (1974)	74a

	Page
Dudley v. Commissioner of Internal Revenue, 258 F. 2d 182 (3d Cir. 1958) ..	65a
Great Western Sugar Co. v. Nelson, 442 U.S. 92 (1979)	74a
Honan v. Commissioner, 48 T.C.M. (CCH) 79 (May 8, 1984)	73a
Insular Sugar Refining Corp. v. Commissioner, 157 F. 2d 673 (2d Cir. 1946)	73a
Iron Arrow Honor Society v. Heckler, 464 U.S. 67 (1983)	74a
Kaufman v. Commissioner, 69 T.C. 473 (1977)	73a
Long v. United States, 742 F. 2d 1173 (9th Cir. 1984)	73a
Malmstedt v. Commissioner, 38 T.C.M. (CCH) 903 (Apr. 10, 1979)	73a
New England Baptist Hospital v. United States, 807 F.2d 280 (1st Cir. 1986)	75a, 78a
New Jersey Turnpike Authority v. Jersey Central Power and Light, 772 F. 2d 25 (3d Cir. 1985)	74a
Olds & Whipple v. United States, 22 F. Supp. 809 (Ct. Cl. 1936)	73a
Teitelbaum v. Commissioner, 346 F. 2d 266 (7th Cir. 1965)	73a
Temple University v. United States, 769 F. 2d 126 (1985)	75a, 78a

	Page	
Tucker Publishing Co. v. Commissioner, 46 B.T.A. 399 (1942)	73a	
United States v. Heinszen & Co. 206 U.S. 370 (1907)	73a	
United States v. Munsingwear, 340 U.S. 36 (1950)	74a	
United States v. Shahadi, 340 F. 2d 56 (3d Cir. 1965)	73a	
Welch v. Henry, 305 U.S. 134 (1938)	75a	
Statutes:		
Internal Revenue Code of 1954 (26 U.S.C.):		
Sec. 934	73a	
Sec. 6214	72a, 73a	
Sec. 6501	72a	
Sec. 6503	72a, 73a	
Sec. 7481	72a	
Sec. 7651	70a, 71a	
Revised Organic Act of the Virgin Islands, c. 558, 68 Stat. 497, Sec. 28		67a, 68a, 70a, 73a-77a
Tax Reform Act of 1986, Pub. L. No. 99- 514, 100 Stat. 2085:		
Sec. 1275	68a, 70a, 71a, 73a-75a	
Sec. 1277	71a, 73a	
V.I. Code Ann., Tit. 33 (1967):		
Sec. 944	72a	
Sec. 1163	72a	
Sec. 1781	72a	
Sec. 1782	65a	

Page

Miscellaneous

H.R. Conf. Rep. No. 99-841, 99th Cong. 2d Sess. at II-682	71a
Rev. Rul. 80-40, 1980-1 Cum. Bull. 175	77a
S. Rep. No. 1271, 83rd Cong., 2d Sess. at 2, 5, 15 ([1954] 2 U.S. Code, Cong. & Ad. News 2585, 2586, 2589, 2600)	75a

IN THE
UNITED STATES COURT OF APPEALS
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No. 86-3091

DANBURY, INC.,
Plaintiff-Appellee

v.

ANTHONY OLIVE, DIRECTOR
BUREAU OF INTERNAL REVENUE
GOVERNMENT OF THE VIRGIN ISLANDS
Respondent-Appellant

ON APPEAL FROM THE JUDGMENT OF THE
DISTRICT COURT
OF THE VIRGIN ISLANDS

BRIEF FOR THE COMMISSIONER OF INTERNAL
REVENUE AS AMICUS CURIAE

This brief is submitted in response to the Court's letter of December 12, 1986, inviting the Commissioner of Internal Revenue of the United States to express his views concerning the issues presented in this case.

STATEMENT OF SUBJECT MATTER
AND APPELLATE JURISDICTION

This action involves a petition by Danbury, Inc., (taxpayer) for redetermination of the income tax deficiency asserted by the Director of the Virgin

Islands Bureau of Internal Revenue (Director-VI). Jurisdiction was conferred upon the District Court by Section 22(b), Revised Organic Act of the Virgin Islands, c. 558, 68 Stat. 497, as amended (48 U.S.C. Section 1612(b)) and by 33 V.I. Code Ann. tit. 33, 944 (1967). See *Dudley v. Commissioner of Internal Revenue*, 258 F. 2d 182, 188 (3d Cir. 1958). The appeal is from a final judgment of the District Court of the Virgin Islands. Jurisdiction to hear the appeal is conferred upon this Court by 28 U.S.C. Section 1291, by Section 23A of the Revised Organic Act of the Virgin Islands, *supra*, as added by Section 705 of Pub. L. 98-454, 98 Stat. 1739, and by V.I. Code Ann., Tit. 33, 1782 (1967).

STATEMENT OF THE ISSUE PRESENTED

Whether Section 1275(b) of the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085, as made applicable to "pre-1987 open years" by Section 1277(c)(2)(B) of that Act, renders this case moot.

STATEMENT OF THE CASE

In this proceeding taxpayer challenges a deficiency in income tax asserted by the Director-VI. (A. 7-28.)¹ On cross-motions for summary judgment, the District Court, in an opinion reported at 627 F. Supp. 513, agreed that the deficiency was improperly asserted. (A. 210-222.) On January 24, 1986, the District Court entered an order in taxpayer's favor invalidating the asserted deficiencies. (A. 4, 223.) On January 28, 1986,

¹ "A." references are to the separately bound record appendix filed by the Virgin Islands.

the Director-VI filed a timely notice of appeal. (A. 1, 4.)

STATEMENT OF THE FACTS

Danbury, Inc. (taxpayer), is an investment corporation organized under the laws of Nevada and owned equally by two shareholders, John M. Aschieris and M. Douglas. Since its creation in 1980, taxpayer has acted solely as a holding company for the shareholder's investments. Taxpayer is headquartered and maintains its only office in the Virgin Islands. Until its records were seized by federal treasury agents in May, 1984, all corporate documents were maintained in the Virgin Islands. Taxpayer had a bank account in the Virgin Islands and, pursuant to its by-laws, holds its shareholder and director meetings in the Virgin Islands. (A. 213.)

Claiming to be an inhabitant of the Virgin Islands as that term is used in Section 28(a), Revised Organic Act of the Virgin Islands, c. 558, 68 Stat. 497, as amended (48 U.S.C. Section 1642) (hereafter ROA Section 28(a)) and claiming to act pursuant to that statute, taxpayer filed no United States tax return, but rather reported all of its income to the Virgin Islands. In 1981 it, reported to the Virgin Islands gross earnings of \$256,118 from limited partnership distributions and interest income. In 1982, it reported to the Virgin Islands gross earnings of \$542,481.05 from limited partnership distributions and interest income and a loss from the sale of diamonds of \$1,576.50. Both sources of income were located in the United States. Taxpayer claimed that all but \$96,985 of its 1982 earnings was exempt from tax by the Virgin Islands and that all of

its 1981 earnings was exempt from tax.² The Director-VI acquiesced in taxpayer's characterization of itself as an inhabitant of the Virgin Islands under ROA Section 28(a)³, but claimed that the income was fully taxable and assessed deficiencies against taxpayer of \$97,750 for 1981 and of \$240,607 for 1982. (A. 7-8, 14, 93, 96, 98, 214.) As stated above, the District Court agreed with the taxpayer that it owed no additional tax to the Virgin Islands. By way of dictum, that court also opined that taxpayer had fulfilled its United States tax obligation. (A. 214.)

This appeal followed. (A. 1.)

STATEMENT OF RELATED CASES AND PROCEEDINGS

See the brief filed by the Director-VI, as appellant, p. 5.

STATEMENT OF THE STANDARD OF REVIEW

The mootness and constitutional issues are questions of law reviewable by this Court *de novo*.

² The record fails to disclose the basis for the admission that \$96,985 of earnings were taxable in the Virgin Islands for 1982. Presumably this amount was sourced in the Virgin Islands.

³ The United States was not a party to this admission by the Virgin Islands. Indeed, on the basis of this record, the United States would likely take the position that the taxpayer here was an inhabitant of the United States and not of the Virgin Islands.

SUMMARY OF ARGUMENT

The first issue presented is whether Section 1275(b) of the Tax Reform Act of 1986 renders this case moot. We submit that it does and that the decision should be vacated and the case remanded with directions to dismiss it as moot.

Section 28(a) of the Revised Organic Act of the Virgin Islands (ROA) provides in pertinent part that “inhabitants of the Virgin Islands” “shall satisfy their income tax obligations under applicable taxing statutes of the United States by paying their tax on income derived from all sources both within and outside the Virgin Islands into the treasury of the Virgin Islands.” Thus, United States citizens or any taxpayers with income sourced in the United States who were “inhabitants of the Virgin Islands” would not, as in the ordinary case, have to file tax returns with the United States and pay their tax obligations to it. Rather, those “inhabitants of the Virgin Islands” would file tax returns with the Virgin Islands and satisfy their total tax obligations by remittance to the Virgin Islands. In the instant case, the Director-VI claims the right to collect tax that otherwise would be owed to the United States by claiming that the taxpayer is an inhabitant of the Virgin Islands.

Section 1275(b) of the Tax Reform Act of 1986 repeals the inhabitant rule and thus eliminates the basis upon which the Virgin Islands may collect tax from a foreign corporation with respect to income sourced in the United States or other foreign country where that income is not effectively connected with a Virgin Islands trade or business. That section is made

applicable to all tax years beginning after 1986 and to all pre-1987 open tax years.

According to the record here, the taxpayer, whose liability to the Virgin Islands is here in dispute, has not filed any income tax return with the United States for the years in question and has, to our knowledge, not paid the disputed tax to the Virgin Islands. Further, the time in which an assessment may be made in the Virgin Islands for the years in question has not run. Accordingly, the years in issue constitute pre-1987 open years. The new statute removes the basis upon which the Director-VI may collect the amounts involved in this suit. Since the statute removes the basis upon which the Director-VI asserts the right to collect, we believe that it renders this case moot and that the decision should be vacated and the cause remanded with directions that it be dismissed.

We question whether taxpayer, in the context of the present suit, is the appropriate party to raise a constitutional challenge to the retroactive features of the statute. In any event, we submit that that legislation is constitutional. Essentially, the taxpayer claims that the application of this 1986 statute deprives him of his property under the Fifth Amendment without due process of law. That claim is without merit. The amendment in question does not change taxpayer's obligation to pay tax on his income from United States sources, but merely changes the entity to whom it pays that tax. The statute removes the potentially unsettling effect of an erroneous court decision (that is not yet final). There is no constitutional impediment to congressional action that imposes no new tax burdens but which merely changes a judicial interpretation that Congress believes to be erroneous and which, if

uncorrected, would result in a substantial windfall to some taxpayers at the expense of the public treasury. When taxpayer undertook this scheme to avoid all taxation on United States source income, there was no more than its hope that it would succeed. Indeed, the opinions of this Court and of the Internal Revenue Service, as well as the clear language used by Congress, indicated that taxpayer's hope was not well founded. In sum, there is no constitutional impediment of applying this 1986 statute to the years in issue here.

ARGUMENT

AS A RESULT OF SECTIONS 1275(b) AND 1277(c)(2)(B) OF THE TAX REFORM ACT OF 1986, THE CASE IS MOOT

The basis for the deficiency asserted by the Director-VI in this case is that the taxpayer is an "inhabitant" of the Virgin Islands as that term is defined in ROA Section 28(a). That section provides in pertinent part that "'inhabitants of the Virgin Islands' . . . shall satisfy their income tax obligations under applicable taxing statutes of the United States by paying their tax on income derived from all sources both within and outside the Virgin Islands into the treasury of the Virgin Islands;" Section 7651(5)(B) of the Internal Revenue Code of 1954 made ROA Section 28(a) applicable to taxes due to the United States under the 1954 Code by treating ROA Section 28(a) as having been enacted subsequent to the enactment of the Internal Revenue Code of 1954.⁴ Section 1275(b) of the

⁴ Section 7651(5)(B), as originally enacted into the Internal

Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085, amended Section 7651(5)(B) to read as follows:

(B) For purposes of this title, section 28(a) of the Revised Organic Act of the Virgin Islands shall be effective as if such section 28(a) had been enacted before the enactment of this title and such section 28(a) shall have no effect on the amount of income tax liability required to be paid by any person to the United States.

The effect of the amendment by Section 1275(b) of the Tax Reform Act was to repeal the Virgin Islands inhabitant rule. H.R. Conf. Rep. No. 99-841. 99th Cong. 2d Sess. at II-682. By virtue of Section 1277(c)(2) of the Tax Reform Act of 1986, the amended version of Section 7651(5)(B) was made applicable with certain exceptions not here pertinent to any pre-1987 open year.⁵ "Pre-1987 open year" is defined in Section 1277(c)(2)(C) as "any taxable year beginning before January 1, 1987, if on the date of the enactment of this Act the assessment of a deficiency of

Revenue Code of 1954, provided that "For purposes of this title (other than section 881(b)(1)) or subpart C of part III of subchapter N of chapter 1, section 28(a) of the Revised Organic Act of the Virgin Islands shall be effective as if such section had been enacted subsequent to the enactment of this title."

⁵ To the extent that the Virgin Islands had either collected a tax by the date of the enactment of the Tax Reform Act of 1986 or, pursuant to a process in effect before August 16, 1986, collected a tax by January 1, 1987, on non-Virgin Islands source or non-Virgin Islands effectively connected income of a Virgin Islands inhabitant that was subject to United States tax for pre-1987 tax years, the amount collected by the Virgin Islands was creditable against the United States tax liability on that income. See, Sec. 1277(c)(2)(B) of the Tax Reform Act of 1986; H.R. Conf. Rep. No. 99-841, *supra* at II-682.

income tax for such taxable year is not barred by any law or rule of law.”

There can be little doubt that the years in issue are open years. For United States tax purposes, the years are still open because, as taxpayer admits, it has not filed any income tax return in the United States for the tax years in question. The statute of limitations has, thus, not begun to run with respect to the assessment of a deficiency of income tax by the United States (Section 6501(c)(3) of the Internal Revenue Code of 1954).

For Virgin Islands tax purposes, the years in issue are also open. Section 944(a) of the V.I. Code Ann., Tit. 33 (1967), confers upon the District Court the power to determine the deficiency in tax and allows the Director-VI to assert increased deficiencies when the claim is made at or before the hearing or rehearing. Section 1163(a)(1), V.I. Code Ann., Tit. 33 (1967), suspends the period on assessments until 60 days after District Court’s decision becomes final. Section 1781, V.I. Code Ann., Tit. 33 (1967), provides that a district court’s decision becomes final when an appeal is taken upon the completion of appellate proceedings or of further proceedings on remand or appeal after remand. Since the District Court’s decision has not become final, the assessment of a deficiency of income tax for the years in issue for Virgin Islands tax purposes was not barred on the date of the enactment of the Tax Reform Act of 1986 by any law or rule of law.⁶

⁶ Sections 944(a), 1163(a)(1) and 1781 of the V.I. Code Ann., Tit. 33 (1967), are virtually identical to Sections 6214(a), 6503(a)(1) and 7481 of the Internal Revenue Code of 1954. Section

Since the tax years are open, Section 1275(b) of the Tax Reform Act of 1986 is applicable to this case. *United States v. Heinszen & Co.* 206 U.S. 370, 387-388 (1907); *Long v. United States*, 742 F. 2d 1173, 1183 (9th Cir. 1984). That section eliminates the inhabitant rule of ROA Section 28(a) and thus removes the basis upon which the Virgin Islands seeks to collect the tax involved herein from the taxpayer.⁷ Since the Virgin Islands no longer has any authority to collect the taxes

6214(a) and 6503(a)(1) suspends the statute of limitations on assessments until 60 days after the decision of the Tax Court becomes final as provided in Section 7481 and Section 6214(a) even permits the Commissioner to assert an increased deficiency. *United States v. Shahadi*, 340 F. 2d 56 (3d Cir. 1965); *Deakman-Wells Co. v. Commissioner*, 213 F. 2d 894, 898 (3d Cir. 1954); *Teitelbaum v. Commissioner*, 346 F. 2d 266, 267 (7th Cir. 1965); *Olds & Whipple v. United States*, 22 F. Supp. 809, 818 (Ct. Cl. 1936); *Honan v. Commissioner*, 48 T.C.M. (CCH) 79, 82-83 (May 8, 1984); *Kaufman v. Commissioner*, 69 T.C. 473 (1977); *Tucker Publishing Co. v. Commissioner*, 46 B.T.A. 399, 414-415 (1942). See also *Insular Sugar Refining Corp. v. Commissioner*, 157 F. 2d 673, 674 (2d Cir. 1946); *Malmstedt v. Commissioner*, 38 T.C.M. (CCH) 903, 904-905 (Apr. 10, 1979), and cases therein cited.

⁷ The taxpayer's suggestion (Nov. 3, 1986, letter, p. 6) that the case might be affected by rules established for sourcing of income under Section 934 of the Internal Revenue Code, as amended by Section 1275(c) of the Tax Reform Act of 1986, cannot withstand analysis. To begin with, Section 1277(a) of the Tax Reform Act of 1986 provides that the amendments to Section 934 apply to taxable years beginning after December 31, 1986. Second, Section 1277(c) of that Act makes the amendments to Section 934 of the Code by Section 1275(c) of the Act applicable only if an implementing agreement complying with the amended provision is in effect between the United States and the Virgin Islands. Third, there is no dispute that for purposes of this case, the income that the Virgin Islands seeks to tax is sourced under rules applicable to Virgin Islands and United States taxation in the United States.

in question, the case here presented has been rendered moot.⁸ Cf. *Iron Arrow Honor Society v. Heckler*, 464 U.S. 67, 70 (1983); *DeFunis v. Odegaard*, 416 U.S. 312 (1974); *County of Los Angeles v. Davis*, 440 U.S. 625 (1979); *New Jersey Turnpike Authority v. Jersey Central Power and Light*, 772 F. 2d 25, 30-31 (3d Cir. 1985).

Accordingly, the judgment below should be vacated with a direction to dismiss the case as moot. See *United States v. Munsingwear*, 340 U.S. 36, 39-41 (1950); *County of Los Angeles v. Davis*, 440 U.S. at 634; *Great Western Sugar Co. v. Nelson*, 442 U.S. 92 (1979).

Nor is there room to question whether the retroactive repeal of the inhabitancy rule of ROA Section 28(a) is constitutional. To begin with, taxpayer has no standing in the context of this litigation to raise any constitutional challenge as to the 1986 legislation. Taxpayer, after all, is absolved of liability to the Director-VI by that legislation. Should the United States seek to recover taxes from taxpayer in some future proceeding, it will be open to taxpayer to challenge the constitutionality of the retroactive features of the 1986 Act.

⁸ There is no merit to the argument advanced by the Director-VI (Nov. 5, 1986, letter to this Court, pp. 8-9) that the amendment by Section 1275(b) of the Tax Reform Act is inapplicable to the taxes here in issue. By its terms, the 1986 Act precludes the Director-VI from collecting under the repealed inhabitant rule any tax owed to the United States for pre-1987 open years with respect to United States and other non-Virgin Islands source income not effectively connected to a Virgin Islands trade or business unless the tax was collected prior to the enactment of the Tax Reform Act. The record does not reveal that taxpayer paid the tax in question. As pointed out by the District Court (A. 217-218), the income in issue herein is non-Virgin Islands sourced income unconnected to any Virgin Islands trade or business.

In any event, even if taxpayer had any standing to advance a constitutional challenge to the 1986 Act, this Court should reject it. As this Court recently pointed out in *Temple University v. United States*, 769 F. 2d 126, 134 (1985), it is well settled “that Congress may, without violating the due process clause, enact legislation having retroactive application if it is justified by a rational legislative purpose.” Whatever may be the limits on the power of Congress to impose new taxes retroactively on profits already received, see *Welch v. Henry*, 305 U.S. 134, 146-151 (1938), it clearly has the power to correct a judicial interpretation of the revenue laws believed to be erroneous. *Temple University v. United States*, 769 F. 2d at 134-135; *Canisius College v. United States*, 799 F. 2d 18, 25-27 (2d Cir. 1986); *New England Baptist Hospital v. United States*, 807 F. 2d 280, — (1st Cir. Dec. 17, 1986). Such corrective legislation should generally be given retroactive effect in accordance with its terms. *Temple University v. United States*, 769 F. 2d at 134. The amendment made by Section 1275(b) of the Tax Reform Act is, as will be shown below, clearly corrective legislation.

When Congress was considering in 1954 the enactment of a revised organic act for the Virgin Islands, it sought ways to give the Virgin Islands additional moneys on a permanent basis so as to make it less likely that the Virgin Islands would have to petition Congress annually for money to support its government and to give that government a greater degree of autonomy. See, S. Rep. No. 1271, 83d Cong., 2d Sess., at 2, 5, 15 ([1954] 2 U.S. Code Cong. & Ad. News 2585, 2586, 2589, 2600). One of the measures, now embodied in ROA Section 28(a) was to permit “inhabitants of the Virgin Islands” “to satisfy their

income tax obligation *under applicable taxing statutes of the United States* by paying their tax on *income derived from all sources* both within and outside the Virgin Islands into the treasury of the Virgin Islands.” ROA Section 28(a) defines inhabitant of the Virgin Islands to “include all persons whose permanent residence is in the Virgin Islands.”

From the statutory language, it is clear that whoever might be an inhabitant of the Virgin Islands was not relieved of any obligation to pay tax on income under the United States taxing statutes. Rather, those “inhabitants” were to satisfy their obligations under the United States taxing statutes by payment to the Virgin Islands. Rather than completing two tax returns for the Virgin Islands (one showing the amount owed to the United States and the other showing the amount owed to the Virgin Islands with a credit for the amount owed to the United States), the inhabitant was to file one return and pay the tax obligation to the Virgin Islands on income from all sources. There is nothing in this language warranting the construction, which the taxpayer and the District Court seek to place upon it, that ROA Section 28(a) provided that an inhabitant could fulfill his obligation to the United States by merely paying tax on income that otherwise might be due to the Virgin Islands under the Code as mirrored.

The term “inhabitant” is, as pointed out earlier, the key to whether the Virgin Islands might collect the tax otherwise due to the United States and not whether that person can escape the full liability of the tax otherwise due the United States under its taxing statutes. The repeal, retroactively, of the “inhabitant” rule thus does not change any tax liability, but at most eliminates a basis upon which the Virgin Islands, rather

than the United States, is entitled to collect the amount of tax.

That the “inhabitant” rule never eliminated tax on any source of income is clear. In describing ROA Section 28(a), this Court in *Chicago Bridge and Iron Co. v. Wheatley*, 430 F. 2d 973, 974 n. 1 (3d Cir. 1970), cert. denied, 401 U.S. 910 (1971) stated:

In 1954, Congress provided that permanent resident of the Virgin Islands (including Virgin Islands corporations) must return and pay taxes to the Virgin Islands on income from all sources. Revised Organic Act of the Virgin Islands 28(a), 48 U.S.C. 1642 (1964). However, corporations domiciled on the mainland and United States citizens not residing permanently in the Virgin Islands must still file two tax returns, one reporting and paying taxes to the Virgin Islands on Virgin Islands income, and the other reporting and paying taxes to the United States on income from all sources, with a credit for taxes paid to the Virgin Islands.

See Rev. Rul. 80-40, 1980-1 Cum. Bull. 175, 176.

While there may be room for a difference of opinion as to the scope of the term “inhabitant” (and, on the basis of this record, the Internal Revenue Service would disagree with the taxpayer’s assertion and the Virgin Islands’ admission that the taxpayer here was an inhabitant of the Virgin Islands⁹, this Court, the

⁹ The parties in this case have agreed that the taxpayer is an inhabitant of the Virgin Islands under ROA Section 28(a). That agreement was the premise upon which the Director-VI founded his assertion of deficiencies and upon which taxpayer founded its

Congress and the Internal Revenue Service have consistently taken the position that an inhabitant must pay tax on its income from all sources in order to fulfill its obligations under the taxing statutes of the United States. Accordingly, there can be no basis for challenging the retroactivity of a taxing statute that merely restates the well-established rule that United States source income is subject to tax and directs that the payment thereof be made to the United States rather than to the Virgin Islands. Certainly, retroactive legislation is not unconstitutional merely because it upsets something akin to a hope that taxes might be avoided. *Temple University v. United States*, 769 F. 2d at 135; *Canisius College v. United States*, 799 F. 2d at 25.

In sum, as to the constitutional issue involved, this case is similar to that of *Temple University v. United States*, *supra*; *Canisius College v. United States*, *supra*; and *New England Baptist Hospital v. United States*, *supra*, wherein this Court, the Second Circuit and the First Circuit held that a statute, which was enacted to prevent disruptive effects on the revenue because of a Supreme Court decision, could be constitutionally applied to tax periods four or more years prior to the date of enactment. Like those cases, the retroactive law affected cases then in litigation.

CONCLUSION

For reasons stated above, we believe that the case is moot and that the decision below should be reversed and the case remanded with directions to dismiss it as moot.

hope of avoiding all tax upon United States source income.

Respectfully submitted,

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FEBRUARY 1987

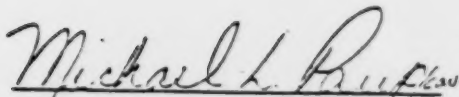
CERTIFICATE OF SERVICE

It is hereby certified that service of this brief has been made on counsel for the Director-VI and on the taxpayer (Danbury, Inc.), by mailing two copies thereof on this 2d day of February, 1987, in an envelope, with postage prepaid, properly addressed to each as follows:

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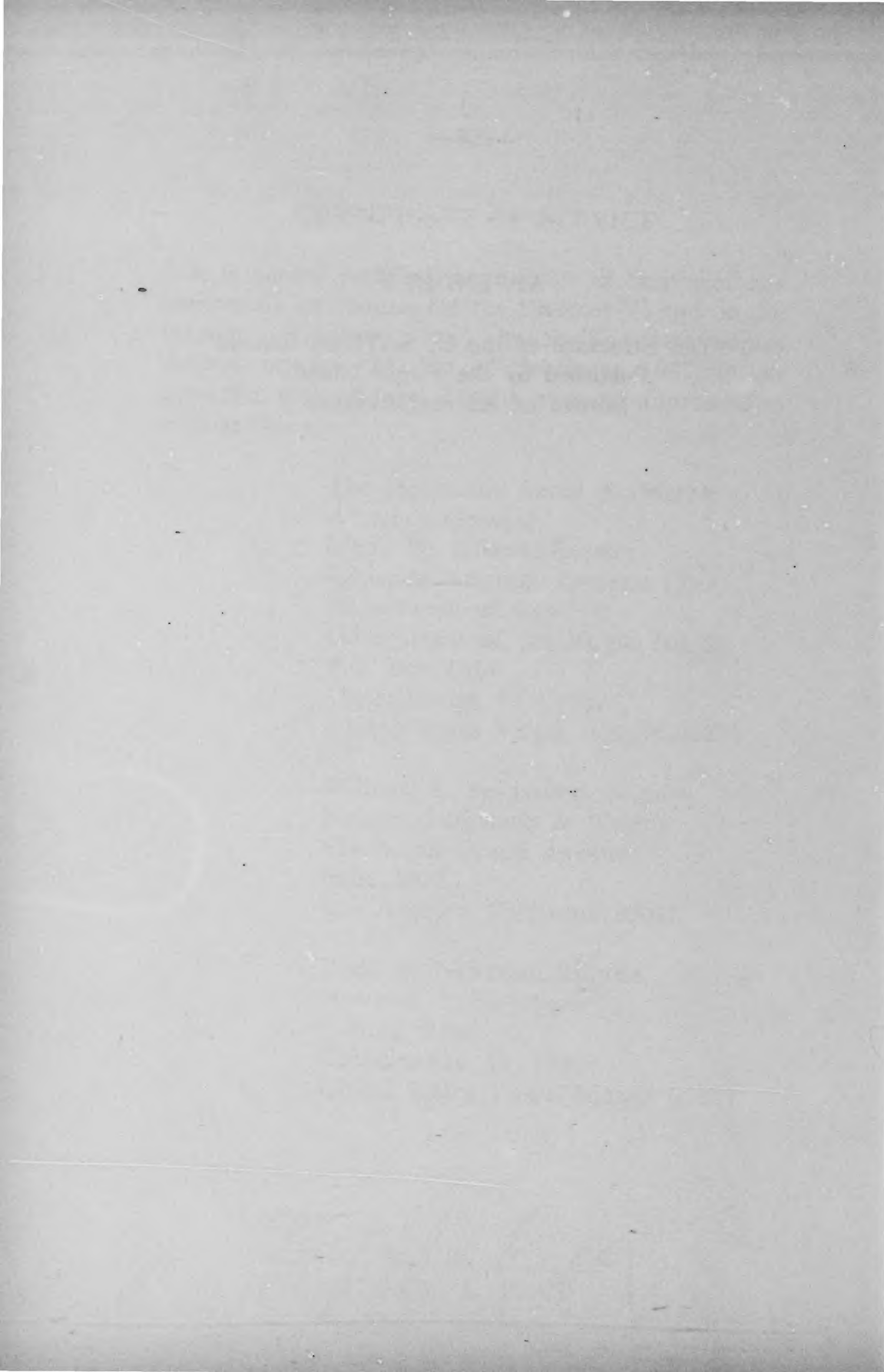
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APPENDIX F

"Tax Structure of the U. S. Virgin Islands"
Published by the Virgin Islands
Bureau of Internal Revenue



APPENDIX F

**TAX STRUCTURE
OF THE
U.S. VIRGIN ISLANDS**



**VIRGIN ISLANDS BUREAU OF
INTERNAL REVENUE**

— 82a —

**TAX STRUCTURE
OF THE
U. S. VIRGIN ISLANDS**

**Published by:
The Government of the Virgin Islands
Juan Luis, Governor**

**Virgin Islands Bureau of Internal Revenue
Leroy A. Quinn, Director**

**REVISED
NOVEMBER 8, 1983**

TABLE OF CONTENTS

Forward	85a
Government	86a
Income Tax-General Discussion	87a
Individual Income Taxes	90a
Corporation Income Taxes	91a
Partnerships	92a
Withholding from Wages, Social Security Taxes and Unemployment Taxes	93a
Withholding of Income Taxes on fixed or determinable income paid to a nonresident	94a
Pension, Profit Sharing, Employee Benefit Plans and Charitable Organizations	94a
Federal Estate Taxes	95a
Federal Gift Taxes	95a
Customs Duties	96a
Miscellaneous Local Internal Revenue Taxes ..	96a
Gross Tax Receipts	96a
Excise Taxes	97a
V. I. Gift Taxes	98a
V. I. Inheritance Taxes	99a
Hotel Room Tax	100a
Highway User's Tax	100a
Performance and Entertainment Tax	101a
Fuel Tax	101a

Local Taxes Administered by other than Virgin Islands Bureau of Internal Revenue	102a
Real Property Taxes	102a
Franchise Taxes and License Fees	103a
Stamp Tax	103a
Workmen's Compensation	104a
V. I. Unemployment Insurance	104a
Special Aid to Business	104a
Industrial Development Program	104a

FORWARD

This publication is issued to provide generalized information concerning income taxes and other Internal Revenue taxes of the U.S. Virgin Islands. It contains information which was current at the date of this preparation.

It has been prepared by the Technical Branch, V. I. Bureau of Internal Revenue, and while every effort has been made to assure accuracy, it is not intended as a substitute for the provisions of the statutes themselves or the court decisions, regulations, or rulings interpreting these in the light of specific facts.

Requests for rulings covering Virgin Islands taxes should be addressed to the Technical Branch — for St. Thomas and St. John, Post Office Box 3186, St. Thomas, Virgin Islands 00801. For St. Croix, Post Office Box 3570, Christiansted, St. Croix, Virgin Islands 00820.

GOVERNMENT

The organization of the Government of the Virgin Islands rests upon the Revised Organic Act of 1954, 68 Stat. 497, in which Congress declared the Virgin Islands (V. I.) to be an unincorporated territory of the United States (U. S.). The executive power of the V. I. is vested in the Governor who, together with the Lieutenant Governor, is elected by the qualified voters in the V. I. for a term of four years.

The Virgin Islands Bureau of Internal Revenue (V. I. BIR) is responsible for the administration of the internal revenue laws of the V. I. The Director of the V. I. BIR is appointed by the Governor, with the advice and consent of the Legislature, and serves for a term coincident with the term of his appointer.

The legislative power and authority of the V. I. is vested in a single chamber consisting of fifteen Senators; seven from St. Croix, seven from St. Thomas, and one Senator-At-Large. Election of Senators is held every two years.

The V. I. is represented in the Congress of the United States by a non-voting Delegate in the House of Representatives who is elected by the voters of the V. I. for a two-year term. He can serve and vote in committee.

The judicial power, as provided in the Revised Organic Act of 1954, is vested in the District Court of the V. I. and the Territorial Court, a court of inferior jurisdiction. The District Court here enjoys a dual role. While it functions as a district court of the U. S. in all causes arising under the Constitution, treaties and laws of the U. S., it also has original jurisdiction in all causes in the Virgin Islands, where exclusive jurisdic-

tion has not been conferred upon the inferior courts. The U. S. Tax Court does not have jurisdiction to hear tax cases arising under the V. I. income tax laws. However, the taxpayer can file a timely petition in the District Court prior to the payment of any asserted income tax deficiency, similar to the procedure in the U. S. Tax Court. Appeals from the decisions of the Court are made to the U. S. Court of Appeals of the Third Circuit in Philadelphia.

The tax system of the Government of the V. I. includes income tax, gross receipts, excise, gift, inheritance, highway user's, hotel room tax, real property, entertainment, franchise, fuel, and stamp taxes. Other fees and license requirements are also in effect.

Whenever the internal revenue laws of the V. I. require the filing of tax returns, statements, notices, or schedules, they should be addressed to the V. I. Bureau of Internal Revenue, Post Office Box 3186, St. Thomas, Virgin Islands 00801, unless otherwise indicated in this publication.

INCOME TAX

The Naval Appropriations Act of July 12, 1921 provided: "... the income tax laws now in force in the United States of America and those which may hereafter be enacted shall be held to be likewise in force in the Virgin Islands of the United States, except that the proceeds of such taxes shall be paid into the treasuries of said islands." Consequently, the Internal Revenue Code (IRC), the Income Tax Regulations, Revenue Rulings, procedures and policies of the U. S. with certain limited exceptions are applicable here.

Section 28(a) of the Revised Organic Act of 1954 provided that inhabitants of the V. I., meaning all persons who are permanent residents of the V. I., “shall satisfy their income tax obligations under applicable taxing statutes of the U. S. by paying their tax on all income derived from all sources both within and outside the V. I. into the treasury of the V. I. . . .” Accordingly, until a U. S. citizen residing in the V. I. files a return and pays the income tax liability to the Virgin Islands, he or she has not satisfied his or her income tax obligations to the U.S.

To help in understanding the application of the Internal Revenue Code to V. I. taxpayers, two principles must be understood:

1. The effect of the above provisions was to create a separate taxing structure in the Virgin Islands by what is termed the “mirror theory” — mirroring the provisions of the IRC by substituting the words Virgin Islands for the words United States whenever necessary to give the law a proper effect.

2. Thus, for purposes of applying the Internal Revenue Code to the Virgin Islands, a domestic corporation is a corporation chartered in the V. I. while a foreign corporation would be one chartered elsewhere. Likewise, an individual (including a U. S. citizen) not residing in the Virgin Islands is considered and taxed as a nonresident while a U. S. citizen or other individual residing in the V. I. is considered a resident and taxed accordingly.

Utilizing the IRC, regulations, and procedures affords the V. I. the benefit of the world’s most sophisticated and successful income tax system. It also enables the V. I. taxpayers to use the hundreds of IRS forms for filing returns, preparing supporting sched-

ules, filing claims, making payments, etc. Only a few of these forms have been slightly modified for local use. Thus, directions in forms or in instructions pamphlets, which make references to District Directors, Commissioner of Internal Revenue, the Internal Revenue Service, Federal Depository, etc., are appropriate for local use. All such references should be interpreted to mean the Director of the V. I. BIR, the V. I. Bureau of Internal Revenue, etc.

A Virgin Islands taxpayer has the same appeal rights concerning disputed income taxes as his counterpart in the U. S. The taxpayer is entitled to a "one level of appeal" hearing, at which the standards and guidelines of settlement are the same as found in the U. S. There is a technical advisor on both St. Thomas and St. Croix to consider written appeals and to grant hearings in disputed tax cases.

A statutory notice of deficiency is issued where agreement on income tax matters is not achieved. However, since the Tax Court does not have jurisdiction to try V. I. income tax cases, the taxpayer may take his case directly to the District Court here without the necessity of first paying the deficiency.

The Delinquent Accounts and Returns Branch of the Bureau is responsible for the collection of all unpaid internal revenue taxes of the V. I. Collection procedures and forms are similar to those followed and used in the U. S., including levies, liens, and seizures.

There are collection and enforcement officers on both St. Thomas and St. Croix. The St. Thomas office jurisdiction includes St. John. The Returns Processing Branch for all three islands is on St. Thomas.

INDIVIDUAL INCOME TAXES

The distinction between V. I. residents and nonresidents is most important. The basis of taxation in the V. I. is residency and source of income. That is, a nonresident of the V. I. is taxed by the V. I. on his or her V. I. source income only, whereas a V. I. resident is taxed on all of his worldwide income. Whether a person in the V. I. is a U. S. citizen is not controlling for purposes of V. I. income tax; rather the question is one of residency, and in case of nonresidents, source of income.

An individual who is a resident of the V. I. and a citizen of the U. S., satisfies his income tax obligations to the U. S. by filing one income tax return with the V. I. Government and including therein his worldwide income for the taxable year and paying the tax thereon to the V. I. Government. An individual will be considered to have been a resident of the V. I. for the full calendar year, if he was a permanent resident at December 31 of that year and not a mere transient or sojourner.

The provisions of the IRC are applied to the V. I. resident generally in the same manner as the IRS applies them in the determination of the income tax liability of the U. S. resident.

Nonresidents of the V. I. are required to pay income taxes into the treasury of the V. I. on income derived from sources in the V. I. Thus, where the nonresident U. S. citizen has income from V. I. sources, from France, and from the U.S., he will file a nonresident return (Form 1040NR) with the V. I. Government covering the V. I. source income, and an income tax return (Form 1040) with the U. S. covering the income

from France, the U. S., and the V. I. In filing his U. S. tax return, Form 1040, the nonresident is entitled to claim a foreign tax credit, subject to certain limitations, for the tax he paid the V. I. on his V. I. source income. Thus, the inclusion of the V. I. source income in the U. S. return does not usually result in double taxation through the benefits of the foreign tax credit.

For the tax year in which residency in the V.I. is terminated, a U.S. citizen has what is referred to as "dual status", i.e. he is V.I. resident from January 1 to July 1 and a resident of the U.S. for the balance of that year. Thus his taxable year is comprised to two periods requiring his filing a return with the V.I. containing his income during the period he was a V.I. resident (January 1 to July 1) and also a return with the U.S. reporting his worldwide income, including V.I., but also claiming any tax paid to the V.I. as a foreign tax credit.

The Foreign Investment in Real Property Tax Act of 1980 is applicable to nonresidents and foreign corporations owning real property interests in the V. I. Under this Act, a V. I. nonresident pays tax attributable to his gain from the sale of V. I. real property into the V. I. Treasury. In addition, nonresident owners of V. I. real property interests are required to report their ownership to the V. I. BIR annually even though they have made no sale during the year. Substantial penalties can be incurred for not complying with this reporting provision.

CORPORATION INCOME TAXES

What has been said covering the individual income tax is, in the main, applicable to corporations. A

domestic corporation, for Virgin Islands income tax purposes, is one which is organized under the laws of the Virgin Islands. A foreign corporation is one which is not organized here.

A domestic corporation pays income taxes on its worldwide income to the V. I. treasury (Form 1120). A foreign corporation pays V. I. income taxes only on its V. I. source income (Form 1120F).

A subchapter S corporation may not have a nonresident as one of its stockholders if it wishes to retain its status as a V. I. subchapter S corporation. A V. I. corporation may not file a consolidated income tax return with a related U. S. tax entity.

The Code does not permit a V. I. corporation to be treated as a Western Hemisphere Trade Corporation or as a DISC.

Section 367, which requires a ruling where a reorganization occurs between a domestic corporation and a foreign subsidiary or parent, must be considered wherever a liquidation, merger, or other form of reorganization occurs between a V. I. corporation and its U. S. subsidiary or U. S. parent.

PARTNERSHIPS

V. I. partnerships file their Form 1065 (Partnership Return of Income) with the V. I. Government the same as their counterparts do in the U. S. If the partnership is engaged in a trade or business then each member, whether resident or nonresident of the V. I., must report their share of the partnership income to the V. I. Government. If the partnership is created or organized in a jurisdiction other than the V. I., it is considered a foreign partnership. However, if at any time during the

taxable year it is engaged in a trade or business in the V. I., it must file a Form 1065 and report that income. Again, its resident or nonresident members must report their share of this income to the V. I. Government.

WITHHOLDING FROM WAGES SOCIAL SECURITY TAXES AND UNEMPLOYMENT TAXES

The V. I. law covering the withholding on wages by employers and remittance to the V. I. Government is the same as in the U. S. insofar as the requirement and amounts thereof are concerned. The withholding and remittance of social security taxes follows the same procedures as in the U. S. with one minor exception.

Income tax withheld from wages paid in the V.I. are remitted to the V. I. BIR and not to the IRS. Form 941 V. I. (Employers Quarterly Withholding Tax Return) is used to report total wages withheld for the quarter, adjustments required for prior quarters, credit for deposits made, and amount due to be paid with the return. Deposits made during the quarter as required by Circular E (Publication 15) are also made to the V. I. BIR, on Form 501 V. I.

Social Security Taxes (FICA) and Federal Unemployment Taxes (FUTA) are in force in the V. I., but being federal taxes, these are not remitted to the V. I. BIR but to the IRS (Philadelphia Service Center). A special Form 941SS is used for FICA purpose. Regular Form 940 is used for FUTA purposes. Circular SS (Publication 80) sets forth the rates and procedures for handling FICA and FUTA taxes.

By January 31st, each employer will give each employee a wage and tax statement for the prior year.

In the Virgin Islands a special form W2-V. I. (Pink) must be used. Form W3-SS is also a special form used to transmit Copy A of Form W2-V. I. (Pink) to the Social Security Administration while Copy 1 of W3-SS transmits Copy 1 of the W2-V. I. (Pink) to the V. I. BIR.

All forms and publications are available in the St. Thomas and St. Croix offices of the V. I. BIR.

WITHHOLDING OF INCOME TAXES ON FIXED OR DETERMINABLE INCOME PAID TO A NONRESIDENT

In December 1982, the U.S. changed the law concerning withholding required by Sections 1441 and 1442 in the case of the 30% tax imposed on fixed or determinable income paid from V.I. sources to non residents. This change in the law decreased the former 30% withholding to 10% and further granted the V.I. Government the prerogative of further decreasing the 10% withholding to zero.

Payments of fixed or determinable income to V.I. residents by U.S. withholding agents may be exempted from withholding where the V.I. resident properly notifies the withholding agent of the fact he expects to meet his U.S. tax obligation by reporting his worldwide income in the V.I.

PENSION, PROFIT SHARING, EMPLOYEE BENEFIT PLANS AND CHARITABLE ORGANIZATIONS

The V. I. has been considered to be a "state" for the provisions of the Pension Reform Act of 1974. Each

plan within the purview of the Act is approved by the IRS.

A charitable organization which is a branch of a charity, national in scope, such as the Red Cross, the American Lutheran Church, and Veterans of Foreign Wars, need not file applications with the V. I. BIR for recognition as a charitable organization. Others should file the required Form 1023 for Sec. 501(c)(3) exempt status and receive a determination letter before contributions thereto will be accepted as deductions. The current practice is to also forward a copy of the Form 1023 to IRS for approval to insure that deductions are allowable to both V. I. and U. S. contributors. Form 1024 is used for exempt applications other than 501(c)(3).

FEDERAL ESTATE TAXES

This tax is administered by the U. S. IRS. Federal Estate taxes are filed and payable to the IRS-Philadelphia Service Center (not the Virgin Islands) and are payable by all U. S. estates (except those of persons born or naturalized in the V. I.) whose value exceeds the total of the exemptions granted by the IRC.

FEDERAL GIFT TAXES

U. S. citizens (except those born or naturalized in the V. I.) residing in the V. I. who make gifts in excess of the annual exclusion must file a Federal Gift tax return with the IRS Center in Philadelphia, Pennsylvania.

CUSTOMS DUTIES

Customs duties in the V.I. are imposed under the U.S. customs law and are administered by the Customs Service, U.S. Treasury Department. Customs duties are at the rate of 6% advalorem on all articles, goods, merchandise and commodities, having a place of manufacture or origin outside the territorial sovereignty of the U.S. and brought into the V.I. However, exemption has been extended to certain specific tourist and construction items imported after November 4, 1982, in an effort to stimulate the V. I. economy.

MISCELLANEOUS LOCAL INTERNAL REVENUE TAXES

The following internal revenue taxes are the product of local legislation and are generally found in Title 33, V. I. Code:

GROSS TAX RECEIPTS

The V.I. gross receipts tax is a tax on total receipts from the conduct of a business within the V.I., whether such receipts are in cash or accruable, and without reduction for cost of goods sold or services or any expenses whatsoever.

The gross receipts tax after November 7, 1983 falls into the following two categories:

1. Those businesses with yearly gross receipts of \$150,000 or more, and
2. Those businesses with yearly gross receipts of less than \$150,000.

Those in Category 1 above pay a tax of 2.75% on their entire receipts.

Those in Category 2 above pay the 2.75% on all receipts in excess of \$5,000 a month.

Monthly gross receipt tax returns are required of all conducting business in the V.I., whether or not any tax is payable.

Commissions earned on the sale of V.I. lottery tickets, gross income of banks, gross income of franchised bus operators and receipts from farming and fishing are not subject to the gross receipts tax. Receipts of the sale of reverse osmosis water production has a partial exemption. The tax does not apply to premiums on insurance written or airline tickets sold but commissions earned by insurance agents and travel agents are subject to the tax.

EXCISE TAX

All persons, firms, and corporations importing goods, merchandise, or commodities into the V.I. for sale or disposition in the course of trade or for processing or manufacture here, pay excise tax on the invoice value of such merchandise landed in the V.I. plus a mark-up of 5%. Rates of tax are on a scale depending upon category.

The rate for drugs, medicine, and clothing is 2%; tires are taxed at 5%; cigarettes, self-propelled vehicles, motorboats, firearms and ammunitions and bicycles are taxed at 10%; U.S. beers are taxed at 0.80 per case; foreign beers at 1.20 per case; liquor at 3.50 per case or 1.46 per wine gallon, whichever is greater. For all other items the rate is 3%. However, importation of certain specific tourist and construction

items after November 4, 1982, have been exempted from excise tax as they have been from custom duty.

After July 1, 1980, when a "Up Front" excise tax system was begun, cargo (both foreign and domestic) imported into the V.I. for business purposes, has been cleared by the U.S. Customs Service. However, importers are required to make payment to the V.I. Bureau of Internal Revenue at time of entry, unless they have a bond or rider to their customs bond. Most merchants have such riders, which gives them until the 15th day of the following month to make payment to the V.I. Bureau of Internal Revenue.

The importation of the following categories of merchandise are exempt from the excise tax: educational materials, most foodstuffs, coal, fuel oil, molasses used in the production of rum, animal and poultry feed, commercial fertilizers, motor vehicles requiring licensing for highway use, and goods, merchandise or commodities brought into the Virgin Islands for disposition in the course of export trade, or to the U.S. or V.I. Governments. However, contractors doing business in the V.I. on government projects are liable for excise tax on their imports. In case items of equipment imported under a lease or rental for a period of 180 days or less, the excise tax is based on the rental charge.

V. I. Gift Taxes

Gifts of property, which has its situs in the V. I., are taxed in the V. I. at the same rate as are bequests and devises. The term property includes real or personal property, tangible or intangible.

On gifts from husband to wife or from wife to husband, and from parents to children, the rate of the gift tax is 5 percent of the fair market value of the gift after deducting the annual \$3,000 exclusion; from brothers to sisters or vice versa, from aunts and uncles to nieces or nephews, the rate of tax is 10 percent on the value of the gift after the exclusion. Gifts to all others are taxed at the rate of 15 percent except gifts to recognized charitable, educational, etc., organizations, upon which there is no tax.

Gift Tax Forms (7090-V. I.) are available from the V. I. BIR.

V. I. Inheritance Taxes

The inheritance tax law of the V. I. has been administered by the District Court of the V. I. Property in an estate is valued at its "true cash value." Debts of the estate are a deduction at their "realization" value. The property of the estate is charged with the funeral expenses of last illness.

The V. I. inheritance law taxes "inheritances which fall from" This has been construed to exclude from the imposition of the inheritance tax intervivos transfers, transfers of property with income retained, transfers into a revocable trust, joint tenancy, tenancy by the entireties, insurance proceeds to a named beneficiary or annuities, transfers causa mortis, transfers taking effect at death, or in contemplation of death.

The rate of tax on inheritances passing to a surviving spouse, from children to parents, and from parents and grandparents to children or grandchildren, is 5 percent of the cash value of such inheritance after an

exemption of \$50,000. A tax of 10 percent is imposed on inheritances to brothers and sisters or nieces and nephews, with an exemption of \$30,000 to the estate. A tax of 15 percent of the cash value of the inheritance is asserted on legacies passing to others, with an exemption of \$5,000.

The inheritance tax is paid into the court having jurisdiction of the probate of the estate before final distribution thereof.

Hotel Room Tax

Every guest of a hotel pays a room tax of 6% of his "net room rate." Charges for food, beverages, gratuities and other incidentals are not part of the "net room rate." A hotel is defined as a building structure or group of structures where sleeping accommodations of 3 or more rooms are offered to the public. The hotel room tax shall be shown as a separate item on the guest's bill and shall be collected by the hotel and remitted to the V. I. BIR monthly on Form 722 V. I.

Highway User's Tax

A highway user's tax is imposed in the V. I. to provide funding for highway construction and maintenance.

Every person or firm (except a person who has owned a motor vehicle for at least two years prior to its importation) before registering a vehicle requiring licensing in the V. I. for the first time, must pay a highway user's tax based upon the unladen weight of the vehicle at the rate of eleven cents per pound with a minimum tax of \$25.00.

Automobiles which are imported for use as taxicabs are exempt from the imposition of the highway user's tax. However, when these cars are registered for the first time in the V. I. as a private vehicle, the person so registering and licensing the car must pay the highway user's tax no matter what period of time has elapsed during which it was licensed as a taxicab.

Performance and Entertainment Tax

A tax at the rate of five percent on the gross receipts is imposed on all performances and entertainments including horse races, theatrical performances, motion pictures, boxing matches, circuses and concerts. However, no tax is imposed where the performance or entertainment is sponsored by a recognized religious, charitable, benevolent, civic, educational, or other organization not giving or promoting the performance or entertainment for profit.

Fuel Tax

A tax, presently at 12 cents a gallon, is imposed upon the sale of gasoline and diesel fuel, manufactured, sold, or consumed in the V. I. Essentially, the tax is upon manufacturer or importer of the fuel.

Fuel sold to the V.I. Government or fuel used for industrial or other purpose not connected with the fueling of motor vehicles, is exempt from this tax.

**LOCAL TAXES ADMINISTERED BY
OTHER THAN VIRGIN ISLANDS
BUREAU OF INTERNAL REVENUE**

The following local taxes and fees are administered by offices other than the V. I. Bureau of Internal Revenue:

Real Property Taxes

Real Property taxes are low in the V.I. compared with such taxes on the mainland. The tax rate of \$1.25 per hundred dollars is applied against 60 percent of "actual value." The real property tax may be reduced by establishing "a homestead" exemption. As of 1/15/85, if the owner occupies at least a portion of the property full time, the first \$15,000 of assessed value is not taxable. For veterans, and widows of veterans, the homestead exemption is \$20,000. Persons 60 years and over having maximum income of \$7,500 per year are granted an exemption of \$20,000 assessed value (or \$250.00 in tax). Maximum exemption is \$20,000 in any case.

That portion of property used solely for farming with sales to the public is entitled to a 95% exemption.

The Lieutenant Governor's office is responsible for the administration of the real property tax. Tax bills are paid to the Treasury Division, Department of Finance.

Franchise Taxes and License Fees

Every corporation organized under the laws of the Virgin Islands and every foreign corporation qualified to do business here is required to pay by June 30th of each year a franchise tax of \$1.50 for each one thousand dollars of capital stock used in conducting business in the V. I. Minimum payment is \$100.00. This tax is administered by the Lieutenant Governor's Office (Chapter 5, Title 13, V. I. C.).

Every individual, partnership, corporation, or firm engaged in the practice of professions, trades and crafts, business and occupations, and manufacturing and processing must obtain an annual license and pay a fee therefor. The details and costs may be found in Chapter 9, Title 27 of the V. I. Code and is administered by the Division of Licensing, Consumer Services Administration.

Stamp Tax

A stamp tax of two percent of the value of the property subject of the transaction is imposed by the Virgin Islands upon the instrument evidencing the conveyance of real property or upon the bill evidencing the sale of personal property. Certified copies of District Court documents are taxed at the rate of \$2.00 for each document.

Stamps are issued by the Department of Finance and sales made by the Recorder of Deeds, the Clerk of the District Court, and any bank or financial institution authorized to do business in the Virgin Islands designated by the Commissioner of Finance (Chapter 7, Title 33, V. I. C.).

Workmen's Compensation

Workmen's compensation insurance is mandatory for every employer of one or more employees in the Virgin Islands. The premium rates vary with the various classifications of employees. Form GIF 1A, Employer's Report to the Commissioner of Finance, is to be filed annually by February 28th to show number of workmen employed, kind of occupation or industry, total wages paid, and amount of premium payable (Chapter 11, Title 24, V. I. C.).

V. I. Unemployment Insurance

As stated above, the U. S. Federal Unemployment Tax Act is in effect in the Virgin Islands which participate as a state under the Act. Contributions by V. I. employers are reported and paid on a quarterly basis to the V. I. Employment Security Agency, Box 9650, St. Thomas, V. I. 00801. Further information is obtainable by phone at 774- 4610 (Chapter 12, Title 24, V. I. C.).

SPECIAL AID TO BUSINESS

Industrial Development Program

Industrial development benefits are granted to certain businesses which locate in the V. I. To qualify, applicants must invest at least \$50,000 exclusive of inventory, employ at least 10 persons full time, be a resident of the V. I., meet requirements of Section 934, comply with all local and federal laws, allow local suppliers a 15% preference, and where applicable, provide free access to the beach or shoreline.

Beneficiaries may be completely exempted from such taxes such as real property taxes, gross receipts taxes, and excise taxes for building materials, machinery, equipment and supplies for use in construction of the physical plant. In addition, a subsidy or refund of up to 90% of income taxes, customs duties and other taxes paid on the importation of raw materials may be granted.

To qualify for benefits, the business must be engaged in assembly, processing of raw materials or products, manufacturing, agriculture, mariculture, transportation, utilities, hotel or guest house operation or recreation.

Initial benefits are for a ten-year period or for fifteen years if located in the District of Frederiksted. Beneficiaries may elect to spread their benefits over a period of 20 years (up to 30 years for Frederiksted) at a proportionately reduced level.

The V. I. Industrial Development Commission, Box 1692, St. Thomas, V. I. 00801, administers this program and any inquiries should be addressed to it.



PROOF OF SERVICE BY MAIL

State of California

ss.

County of Los Angeles

I, the undersigned, say: I am and was at all times herein mentioned, a citizen of the United States and a resident of the County of Los Angeles, over the age of eighteen (18) years and not a party to the within action or proceeding; that my business address is 10835 Santa Monica Boulevard, Los Angeles, California 90025; that on September 25 1987, I served the within *Petition for Writ of Certiorari* in said action or proceeding by depositing true copies thereof, enclosed in a sealed envelope with postage thereon fully prepaid, in the United States mail at Los Angeles, California, addressed as follows:

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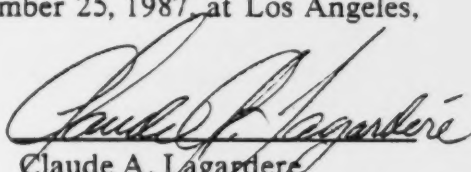
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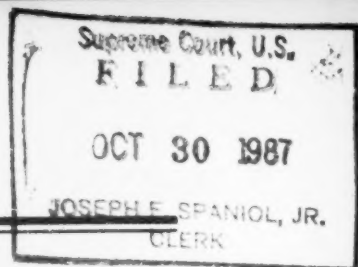
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I declare under penalty of perjury that the foregoing is true and correct. Executed on September 25, 1987, at Los Angeles, California.


Claude A. Lagardere
(Original signed)



No. 87-541



IN THE
Supreme Court of the United States

OCTOBER TERM, 1987

DANBURY, INC.,

v.

Petitioner,

ANTHONY P. OLIVE, DIRECTOR
BUREAU OF INTERNAL REVENUE
GOVERNMENT OF THE VIRGIN ISLANDS,
Respondent.

On Petition for a Writ of Certiorari to the United States
Court of Appeals for the Third Circuit

BRIEF IN OPPOSITION

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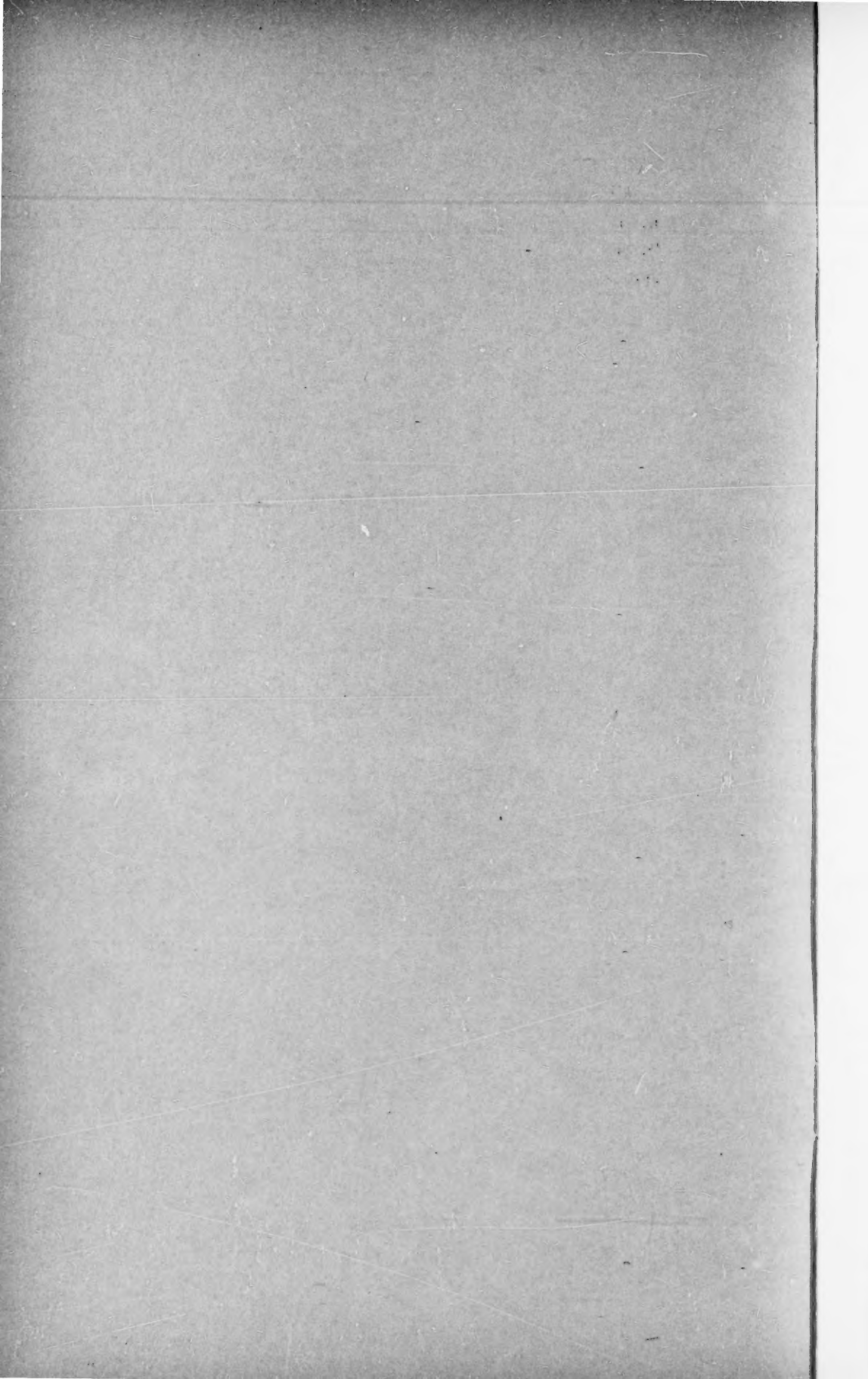
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QUESTION PRESENTED

Whether a United States corporation, which qualifies as an "inhabitant" of the Virgin Islands under Section 28(a) of the Virgin Islands Revised Organic Act, owes tax on its worldwide income to the Virgin Islands.



TABLE OF CONTENTS

	Page
QUESTION PRESENTED	i
TABLE OF AUTHORITIES	iv
STATEMENT OF THE CASE	2
A. The Undisputed Facts Giving Rise To This Case	2
B. The Applicable Taxing Statutes Of The Virgin Islands	3
C. The Decisions Below	6
REASONS FOR DENYING THE WRIT	7
A. The Decision Below Is Not In Conflict With The Decisions Of Any Other Circuit And Is Fully Consistent With Prior Precedent	8
B. The Decision Below Does Not Present Any Is- sue Concerning The TRA-86 That Is Ripe For Review By This Court	10
CONCLUSION	12

TABLE OF AUTHORITIES

<i>Cases</i>	<i>Page</i>
<i>Brotherhood of Locomotive Firemen & Enginemen v. Bangor & Aroostook R.R. Co.</i> , 389 U.S. 327 (1967) -----	10
<i>Chicago Bridge and Iron Co. v. Wheatley</i> , 430 F.2d 973 (3d Cir. 1970), <i>cert. denied</i> , 401 U.S. 910 (1971) -----	9, 10
<i>Commissioner v. Rivera's Estate</i> , 214 F.2d 60 (2d Cir. 1954) -----	8
<i>Davis v. United States</i> , 417 U.S. 333 (1974) -----	10
<i>Dudley v. Commissioner of Internal Revenue</i> , 258 F.2d 182 (3d Cir. 1958) -----	8, 9
<i>Graham & Foster v. Goodcell</i> , 282 U.S. 409 (1931) -----	11
<i>HMW Indus., Inc. v. Wheatley</i> , 504 F.2d 146 (3d Cir. 1974) -----	9
<i>Keller v. Adams-Campbell Co.</i> , 264 U.S. 314 (1924) -----	8
<i>Layne & Bowler Corp. v. Western Well Works, Inc.</i> , 261 U.S. 387 (1923) -----	8
<i>Pan American World Airways, Inc. v. Duly Authorized Government of the Virgin Islands</i> , 459 F.2d 387 (3d Cir. 1972) -----	9
<i>Vitco, Inc. v. Government of the Virgin Islands</i> , 560 F.2d 180 (3d Cir. 1977), <i>cert. denied</i> , 435 U.S. 980 (1978) -----	9, 10
<i>Welch v. Henry</i> , 305 U.S. 134 (1938) -----	11
<i>Wisconsin Electric Co. v. Dunmore Co.</i> , 282 U.S. 813 (1931) -----	8

Statutes

Naval Service Appropriation Act, 1922, ch. 44, § 1, 42 Stat. 123 (1921) (codified as amended at 48 U.S.C. § 1397 (1982)) -----	<i>passim</i>
Revised Organic Act of the Virgin Islands, ch. 558, § 28(a), 68 Stat. 508 (1954) (codified as amended at 48 U.S.C. § 1642 (1982)) -----	<i>passim</i>
Tax Reform Act of 1986, Pub. L. No. 99-514, §§ 1275 and 1277, 100 Stat. 2085 (1986) -----	<i>passim</i>
26 U.S.C. § 61 (1982 and Supp. III 1985) -----	4
26 U.S.C. § 882(b) (1982) -----	4

TABLE OF AUTHORITIES—Continued

	Page
26 U.S.C. §§ 901-908 (1982 and Supp. III 1985) --	4
26 U.S.C. § 7651(5)(B) (1982 and Supp. III 1985) -----	5
28 U.S.C. § 1291 (1982) -----	8
48 U.S.C. § 1612 (1982 and Supp. III 1985) -----	8
26 U.S.C.A. § 7651(5)(B) (West Supp. 1987) ----	5
 <i>Miscellaneous</i>	
Fed. R. App. P. 35(a) -----	10
Rev. Proc. 80-57, 1980-2 C.B. 852 -----	12
Rev. Rul. 80-40, 1980-1 C.B. 175 -----	9



IN THE
Supreme Court of the United States

OCTOBER TERM, 1987

No. 87-541

DANBURY, INC.,

Petitioner,

v.

ANTHONY P. OLIVE, DIRECTOR
BUREAU OF INTERNAL REVENUE
GOVERNMENT OF THE VIRGIN ISLANDS,
Respondent.

**On Petition for a Writ of Certiorari to the United States
Court of Appeals for the Third Circuit**

BRIEF IN OPPOSITION

Respondent, Anthony P. Olive, Director, Bureau of Internal Revenue of the Government of the Virgin Islands (hereinafter "VIBIR"), opposes the Petition for a Writ of Certiorari. The Petition raises no issue worthy of review by this Court. On the precise tax question presented, there is no conflict among the circuits, there is no contrary ruling by this Court, nor has there even been a final tax assessment in the case at issue.

Respondent does not challenge Petitioner's assertions under the headings of Opinions Below, Jurisdiction, and

Statutory Authority Involved. Respondent does challenge Petitioner's Statement Of The Case. Because the Petition omits relevant facts and conclusions necessary to understand the decision below, Respondent submits the following statement.

STATEMENT OF THE CASE

This case involves an attempt by the Petitioner, a U.S. corporation chartered in Nevada, to avoid any tax on all of its U.S. source investment income. Petitioner structured its corporate activities to qualify as an "inhabitant" of the Virgin Islands under the Revised Organic Act of the Virgin Islands, while claiming that it is only subject to tax as a "foreign corporation" under the Territory's "mirror tax" code. The company argues that its U.S. source income is foreign source income under the Virgin Islands mirror code and, thus, not taxable by the Territory. At the same time, the company claims that it owes no U.S. tax because, as an "inhabitant" of the Virgin Islands, it satisfies its entire U.S. income tax obligations by filing its tax returns in and paying its applicable tax under the mirror code to the Virgin Islands.

The United States Court of Appeals for the Third Circuit rejected this "creative" interpretation of the Revised Organic Act of the Virgin Islands and this Petition for a Writ of Certiorari followed.

A. The Undisputed Facts Giving Rise To This Case

The facts underlying the dispute are, as the court below noted, "simple and uncontested." (Petition No. 87-541 For a Writ of Certiorari (hereinafter "Pet."), Petition Appendix (hereinafter "Pet. App.") 21a). Petitioner is a U.S. corporation which is "a holding company for the investments of its two [individual U.S.] shareholders." (Pet. App. 21a). "Although incorporated under the laws of Nevada, [Petitioner] keeps all its corporate documents at its sole office in the Virgin Islands, maintains a

Virgin Islands bank account, and holds all its shareholders' and directors' meetings in the [Territory]." (Pet. App. 21a). On the basis of these stipulated facts, Petitioner was found to be a permanent resident and, thus, an "inhabitant" of the Virgin Islands under the Territory's Revised Organic Act of The Virgin Islands, ch. 558, § 28(a), 68 Stat. 508 (1954) (codified as amended at 48 U.S.C. § 1642 (1982)) (hereinafter "ROA"). (Pet. App. 27a).

Petitioner filed a Virgin Islands income tax return for 1981 with the VIBIR, disclosing income of \$256,118, but paying no tax. (Pet. App. 21a). Petitioner filed its 1982 income tax return with VIBIR, disclosing "taxable income" of \$96,985 and other income of \$526,057.55 and paid VIBIR a total of \$26,243 on its 1982 return. (Pet. App. 21a-22a). Petitioner's reported income on its 1981 and 1982 returns, other than the income reported as taxable, was derived from sources outside of the Virgin Islands and was income not effectively connected with a Virgin Islands trade or business. (Pet. App. 22a). Petitioner did not file an income tax return for either 1981 or 1982 with the U.S. Internal Revenue Service (hereinafter "IRS"). (Pet. App. 22a).

The VIBIR issued a statutory notice of deficiency to Petitioner in the amount of \$97,750 for tax year 1981 and \$240,607 for tax year 1982, stating that, under the ROA of the Virgin Islands, Petitioner owed tax to the Virgin Islands on its worldwide income. (Pet. App. 22a). Petitioner then filed a petition for redetermination of the asserted tax deficiency in the District Court of the Virgin Islands.

B. The Applicable Taxing Statutes Of The Virgin Islands

At the time this action was filed in the district court, a Virgin Islands inhabitant company incorporated in the United States—such as Petitioner—was obligated to pay taxes into the Virgin Islands treasury pursuant to two statutory sources. First, the Naval Service Appropriation Act, 1922, ch. 44, § 1, 42 Stat. 123 (1921) (codified

as amended, at 48 U.S.C. § 1397 (1982)), established the "mirror tax" system, under which the U.S. Internal Revenue Code (hereinafter "IRC") is "mirrored" in the Virgin Islands by substituting the words "Virgin Islands" for the words "United States" in the IRC (hereinafter "mirror code"). (Pet. App. 23a). Under the Virgin Islands mirror code, Petitioner is obligated to pay taxes to the Virgin Islands on its Virgin Islands source income and income effectively connected with a Virgin Islands trade or business. 26 U.S.C. § 882(b) (1982) (mirrored). (Pet. App. 27a-28a).

Second, Section 28(a) of the ROA, enacted by Congress in 1954, directs that a U.S. corporation, which qualifies as an "inhabitant" of the Virgin Islands, shall satisfy its separate U.S. income tax¹ by paying its applicable tax under the IRC to the Virgin Islands (hereinafter the "inhabitant rule"). Section 28(a) provides, in pertinent part:

[T]he proceeds of customs duties, the proceeds of the United States income tax, [and] the proceeds of any taxes levied by Congress on the inhabitants of the Virgin Islands . . . shall be covered into the treasury of the Virgin Islands . . . *Provided*, That the term "inhabitants of the Virgin Islands" as used in this section shall include all persons whose permanent residence is in the Virgin Islands, and such persons shall satisfy their income tax obligations under applicable taxing statutes of the United States by paying their tax on income derived from all sources both within and outside the Virgin Islands into the treasury of the Virgin Islands. . . .

ROA, 48 U.S.C. § 1642.

To ensure proper application of the "inhabitant rule" set forth in Section 28(a) of the ROA, Congress also enacted an ordering rule in the IRC, which provided:

¹ The U.S. Internal Revenue Code (hereinafter "IRC") imposes tax on a U.S. corporation's worldwide income, 26 U.S.C. § 61 (1982 and Supp. III 1985), but generally provides a foreign tax credit for taxes paid to the Virgin Islands. 26 U.S.C. §§ 901-908 (1982 and Supp. III 1985).

For the purposes of this title . . . section 28(a) of the Revised Organic Act of the Virgin Islands shall be effective as if such section had been enacted *subsequent* to the enactment of this title.

26 U.S.C. § 7651(5)(B) (1982 and Supp. III 1985) (emphasis added). Consequently, the provisions of the “inhabitant rule,” requiring payment of taxes into the Virgin Islands treasury, superseded the provisions of the IRC that would have otherwise required Petitioner to pay its tax on its worldwide income to the IRS. Thus, the Naval Service Appropriation Act (mirror code) and the ROA, as described above, constituted the basic tax structure of the Virgin Islands at the time the Petitioner contested the VIBIR statutory notice of deficiency in the Virgin Islands District Court.

After the decision by the district court and while this case was pending on appeal, Congress enacted the Tax Reform Act of 1986, Pub. L. No. 99-514, § 1275, 100 Stat. 2085, 2598 (1986) (hereinafter “TRA-86”), which, *inter alia*, amended 26 U.S.C. § 7651(5)(B) to modify the application of the “inhabitant rule” of Section 28(a) of the ROA for certain tax years.² Pursuant to Section 1277(c)(2) of the TRA-86, this amendment was made effective only for (1) all tax years commencing after December 31, 1986, and (2) certain “pre-1987 open years.” 100 Stat. at 2601.³

² In particular, the Tax Reform Act of 1986, Pub. L. No. 99-514, § 1275, 100 Stat. 2085, 2598 (1986) (hereinafter “TRA-86”) amended the ordering rule in the IRC to read:

For purposes of this title, section 28(a) of the Revised Organic Act of the Virgin Islands shall be effective as if such section 28(a) had been enacted *before* the enactment of this title and such section 28(a) shall have no effect on the amount of income tax liability required to be paid by any person to the United States.

26 U.S.C.A. § 7651(5)(B) (Supp. 1987) (emphasis added).

³ The TRA-86, under § 1277(c)(2)(C), defines a “pre-1987 open year” as any taxable year beginning before January 1, 1987, “if on the [October 22, 1986] date of enactment of this Act, the

For tax years to which the modified "inhabitant rule" established by TRA-86 applies, a U.S. corporation which is an inhabitant of the Virgin Islands is required to pay (1) tax on its Virgin Islands source and effectively connected income under the mirror code to the Virgin Islands, and (2) tax on its worldwide income under the IRC to the United States, with a foreign tax credit for taxes paid to the Virgin Islands.

C. The Decisions Below

On cross motions for summary judgment, the district court held that the Petitioner was subject to tax only on its Virgin Islands source income and on income effectively connected with a Virgin Islands trade or business. (Pet. App. 2a). The district court reasoned that the "inhabitant rule" could not be construed to alter the distinction between domestic and foreign corporations or to amend the sourcing rules under the Virgin Islands mirror code. (Pet. App. 12a-14a).

Relying on the plain language of Section 28(a), the court of appeals reversed the judgment of the district court, holding that the court had erred in viewing the case as an attempt by the VIBIR to amend the mirror code. (Pet. App. 21a, 30a and 34a). The court held that the "inhabitant rule" did not operate to extinguish a corporate inhabitant's liability for U.S. taxes, but simply directed an "inhabitant," such as Petitioner, to pay both its U.S. and V.I. tax liabilities to the Virgin Islands. Thus, the court of appeals concluded "that the district court should have awarded the [VIBIR] summary judgment" (Pet. App. 34a).

However, the court of appeals noted that a final disposition of this case could not be ordered until the effect of the intervening enactment of TRA-86 was assessed.

assessment of a deficiency of income tax for such taxable year is not barred by any law or rule of law." 100 Stat. at 2601.

(Pet. App. 35a-41a). Based on its analysis of that intervening Act, the court ruled that Petitioner would be required to pay both its mirror tax and U.S. tax liabilities for the 1981 and 1982 tax years in question to the VIBIR, unless such tax years constituted "pre-1987 open years" within the meaning of the effective date provisions of TRA-86. (Pet. App. 37a and 41a). The court held that the general three-year statute of limitations would have barred any additional assessment of income tax by the IRS at the time of enactment of TRA-86. Thus, the tax years in question would be "pre-1987 open years" *only* if Petitioner were found to have filed a false return or willfully attempted to evade tax. (Pet. App. 40a). The court of appeals thus remanded the case to the district court to make the necessary factual determinations on this limited issue and to enter an appropriate final order. (Pet. App. 40a-41a).

REASONS FOR DENYING THE WRIT

The decision below and disposition of this case by the court of appeals raise no issue worthy of review by this Court. As to the court of appeals' interpretation of the pre-TRA-86 "inhabitant rule" of the ROA, the decision below does not conflict with the decisions of any other circuit, was correctly decided, and does not present any other basis for granting the writ. Moreover, the only practical dispute between the parties to this case—whether VIBIR can collect the tax deficiencies assessed for 1981 and 1982—has been remanded to the district court for further fact-finding to determine whether Petitioner must pay the disputed deficiencies to the VIBIR. Consequently, the issues raised in the petition concerning the court of appeals' interpretation of TRA-86 lack the finality normally required to present a matter worthy of review by this Court.

A. The Decision Below Is Not In Conflict With The Decisions Of Any Other Circuit And Is Fully Consistent With Prior Precedent

Contrary to Petitioner's assertion, there is *no* conflict between the decision below and the decisions of any other circuit. The sole case relied upon by Petitioner—*Commissioner v. Rivera's Estate*, 214 F.2d 60 (2d Cir. 1954)—is simply inapposite. While both this case and *Rivera's Estate* involve interpretation of tax provisions, they involve entirely different and distinct tax laws and facts.⁴ Inconsistencies in *dicta* or in the general principles utilized in these cases, if any, are insufficient to establish a conflict between the circuits. See *Layne & Bowler Corp. v. Western Well Works, Inc.*, 261 U.S. 387, 392-93 (1923); *Keller v. Adams-Campbell Co.*, 264 U.S. 314 (1924); *Wisconsin Electric Co. v. Dunmore Co.*, 282 U.S. 813 (1931).⁵

Nor is there any inconsistency between the decision below and prior Third Circuit precedent. As the Third Circuit tacitly acknowledged when it denied Petitioner's request for *en banc* rehearing, no such conflict exists between the decision below and the Third Circuit's earlier decision in *Dudley v. Commissioner of Internal Revenue*,

⁴ This case involves income taxes, under the U.S. Internal Revenue Code and the Revised Organic Act of the Virgin Islands, ch. 558, § 28(a), 68 Stat. 508 (1954) (codified as amended at 48 U.S.C. § 1642 (1982)) (hereinafter "ROA"), payable to the Virgin Islands, and facts related thereto. *Commissioner v. Rivera's Estate*, 214 F.2d 60 (2d Cir. 1954) involved U.S. estate taxes, a Puerto Rican estate, and facts related thereto.

⁵ It is unlikely that there could ever be an inconsistency between the Third Circuit and any other circuit involving Virgin Islands tax matters. See 28 U.S.C. § 1291 (1982); 48 U.S.C. § 1612 (1982 and Supp. III 1985). See also *Dudley v. Commissioner of Internal Revenue*, 258 F.2d 182, 188 (3d Cir. 1958) (U.S. Tax Court has no jurisdiction over petition for redetermination of tax deficiency issued by Virgin Islands; Virgin Islands District Court has exclusive jurisdiction over such cases).

258 F.2d 182 (3d Cir. 1958).⁶ That case involved a Virgin Islands taxpayer who petitioned the Tax Court of the United States—rather than the District Court of the Virgin Islands—for a redetermination of his Virgin Islands income tax liability. In affirming the Tax Court's dismissal of the petition for lack of jurisdiction, the court of appeals held that the tax in dispute was a territorial tax, imposed under the Virgin Islands mirror code, and not a tax of the United States. *Id.* at 185. At the same time, the court distinguished the territorial tax under the mirror code from the separate U.S. income tax obligations that Section 28 of the ROA requires an inhabitant to pay into the Virgin Islands treasury. *Id.* at 188.⁷

Thus, both *Dudley* and the decision below stand for the proposition that a Virgin Islands inhabitant is subject to both Virgin Islands mirror tax and U.S. income tax. Indeed, both cases recognize that, under the "inhabitant rule" set forth in Section 28(a) of the ROA, a Virgin Islands inhabitant shall satisfy its U.S. and V.I. income tax obligations by paying both taxes to the Virgin Islands. *Accord* Rev. Rul. 80-40, 1980-1 C.B. 175; *see also Vitco, Inc. v. Government of the Virgin Islands*, 560 F.2d

⁶ Petitioner also relies on *HMW Indus., Inc. v. Wheatley*, 504 F.2d 146 (3d Cir. 1974), *Pan American World Airways, Inc. v. Duly Authorized Government of the Virgin Islands*, 459 F.2d 387 (3d Cir. 1972), and *Chicago Bridge and Iron Co. v. Wheatley*, 430 F.2d 973 (3d Cir. 1970), *cert. denied*, 401 U.S. 910 (1971). The quotations from these cases, on which Petitioner relies, are inapposite. They involve interpretation only of the Naval Service Appropriation Act (i.e., the mirror code tax) and *not* an "inhabitant's" liability for U.S. income tax under the ROA.

⁷ Petitioner suggests that the decision below will cause disarray and chaos for Virgin Islands inhabitants. (Pet. 18). In order to suffer from such confusion, one must wholly fail to recognize the distinction between the taxing authority granted to the Virgin Islands by the Naval Service Appropriation Act which created the "mirror code" and the additional collection authority granted under the ROA of 1954 which created the "inhabitant rule" set forth in Section 28(a).

180 (3d Cir. 1977) (Virgin Islands corporation is an "inhabitant" corporation taxable by the Territory on its worldwide income, notwithstanding minimal contacts in the Virgin Islands), *cert. denied*, 435 U.S. 980 (1978); *Chicago Bridge and Iron Co. v. Wheatley*, 430 F.2d 973, 974 n.1 (3d Cir. 1970) (ROA provides that corporate inhabitants of the Virgin Islands "must return and pay taxes to the Virgin Islands on income from all sources"), *cert. denied*, 401 U.S. 910 (1971).

In any event, the existence of conflict within a circuit is not a sufficient basis for granting certiorari. See *Davis v. United States*, 417 U.S. 333, 340 (1974). Such conflicts are intramural in nature and are to be resolved by the circuit through *en banc* proceedings pursuant to Rule 35(a), Federal Rules of Appellate Procedure. Fed. R. App. P. 35(a).

B. The Decision Below Does Not Present Any Issue Concerning The TRA-86 That Is Ripe For Review By This Court

Petitioner raises numerous constitutional and other challenges to the interpretation and application of the TRA-86 by the court below. Because the court of appeals remanded the case, however, none of those issues is "yet ripe for review by this Court." *Brotherhood of Locomotive Firemen & Enginemen v. Bangor & Aroostook R.R. Co.*, 389 U.S. 327, 328 (1967). Indeed, certain issues raised by the Petition, such as the asserted unconstitutional retroactive application of the TRA-86 (Pet. App. 12 and 16; Pet. App. 36a n.4), are not issues raised by this case at all.

Petitioner does not contend that an order requiring the payment of tax deficiencies to the VIBIR would be a retroactive application of the TRA-86. In fact, Petitioner flatly asserts that "Danbury's 1981 and 1982 income taxes, if any, are properly payable to the Virgin Islands" (Pet. 13). On remand, the district court will

only decide whether Petitioner must pay the assessed deficiencies to the Virgin Islands.⁸ Thus, this case does not at this time, and will not when finally resolved, raise the “retroactive application” issues which Petitioner argues. Those issues will be presented, if ever, only in a case where the IRS issues and seeks to enforce, against Petitioner or a similarly situated corporation, a timely notice of tax deficiency for a “pre-1987 open year.” Therefore, the arguments in Sections III, V, VI and VII of the Petition (Pet. 10-11 and 12-17) need not be addressed at all in resolving this case and present no basis for review of the decision below by this Court.

This Court’s review of the decision below is unwarranted, moreover, because of the character of the underlying complaint. The decision below may disappoint these taxpayers’ ill-conceived expectation of avoiding payment of any tax on their U.S. source income—an expectation which the court below described as founded solely on “the ‘creative’ analysis offered by [an] article in *Tax Management*, [a private publication,] rather than [on] a rational consideration of the actual taxing and administrative statutes.” (Pet. App. 34a). But, taxpayers have no reasonable expectation to escape taxation. This Court has repeatedly held that taxation is neither a penalty nor a liability governed by contract principles but merely a way of apportioning the costs of government among those who enjoy its benefits. See *Welch v. Henry*, 305 U.S. 134, 144 (1938). Accordingly, the courts have consistently read tax statutes to cure defects and eliminate potential abuses of specific provisions of the tax code. See *Graham & Foster v. Goodcell*, 282 U.S. 409 (1931). Here, no liberal interpretation of the ROA was required to reject the tax avoidance scheme asserted by Petitioner. The language and meaning of Section 28(a) are plain. In

⁸ Petitioner appears to recognize that the District Court for the Virgin Islands does not have jurisdiction in this case to entertain an action on a statutory notice of deficiency issued by the IRS. (Pet. 11).

order to satisfy its U.S. income tax obligations under the inhabitant rule, Petitioner must pay its applicable U.S. tax to the Virgin Islands.⁹

CONCLUSION

The opinion below is correctly decided, does not conflict with any precedent of this Court or, indeed, of any other court, and, in any event, has caused no final assessment of tax deficiency to be made. Thus, no basis exists for granting the Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit. Respondent respectfully requests that the Petition be denied.

Respectfully submitted,

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⁹ To the extent a risk of double taxation may arise as a result of a taxpayer's status in any particular case, the tax authorities of the Virgin Islands and the United States have established procedures to resolve any conflicts between the two taxing jurisdictions. *See* Rev. Proc. 80-57, 1980-2 C.B. 852.

